Supreme Court, U. S.
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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1979

No. 79-2050

Chrome Plate, Inc., Petitioner

v.

United States of America, Respondent

Petition for a Writ of Certiorari
to the United States Court of Appeals
for the Fifth Circuit

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UNITED STATES OF AMERICA, Respondent

Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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Petitioner requested that a writ of Certiorari be issued to review the decision of the United States Court of Appeals for the Fifth Circuit in this case (No.77-3402) which was entered on April 2, 1980.

OPINION BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit (App. A, infra, pp. A-1 to A-17) is reported in 614 F.2d 990 (5th Cir. 1980). The opinion of the United States District Court, Western District of Texas, San Antonio (App. B, infra, pp. B-1 to B-13) is reported in 442 F. Supp. 1023. The judgment of the United States District Court for the Western District of Texas, San Antonic Division setting in Bankruptcy and its memorandum of Decision (App. C., infra, pp. C-1 to C-9) is unreported.

JURISDICTION

The opinion of the United States Court of Appeals for the Fifth Circuit was entered on April 2, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Should petitioner who has fully complied with all of the requirements as intended by Congress in order to obtain a cost of stock basis in assets, as well as fully complying with the requirements set out by the Court of Claims, be denied that tax treatment?

STATUTORY PROVISIONS AND JUDICIALLY CREATED DOCTRINES INVOLVED

The pertinent provisions of the statute and judicially created doctrines are set forth in Appendix D, infra, pp. D-1 to D-5.

STATEMENT OF THE CASE

1. BACKGROUND

This case involves the tax consequences arising out of a series of corporate transactions in which the Petitioner purchased the stock of six corporations from unrelated third persons which was a taxable transaction to the sellers. At that time, Petitioner was a corporation primarily engaged in the business of chrome plating aircraft cylinders. The sellers were engaged in the sale and repair of airplanes and airplane engines through six corporations and a sole proprietorship.

The sellers refused to sell the assets of the six corporations. They would only sell the stock. After extensive negotiations and research, the transaction was carefully planned and executed in order to fulfill the restrictive collateral requirements of the sellers and the tax needs of all parties.

On December 28, 1972, the sellers sold all of their stock in the six corporations to Petitioner in a transaction taxable to the sellers. Chrome Plate Industries, Inc. (first tier subsidiary), was a newly formed corporation incorporated in December 1972, all of the outstanding stock of which was owned by Petitioner. In payment for their stock in the six corporations, sellers received from Chrome Plate Industries, Inc., $39,000 in cash and $811,000 in notes.

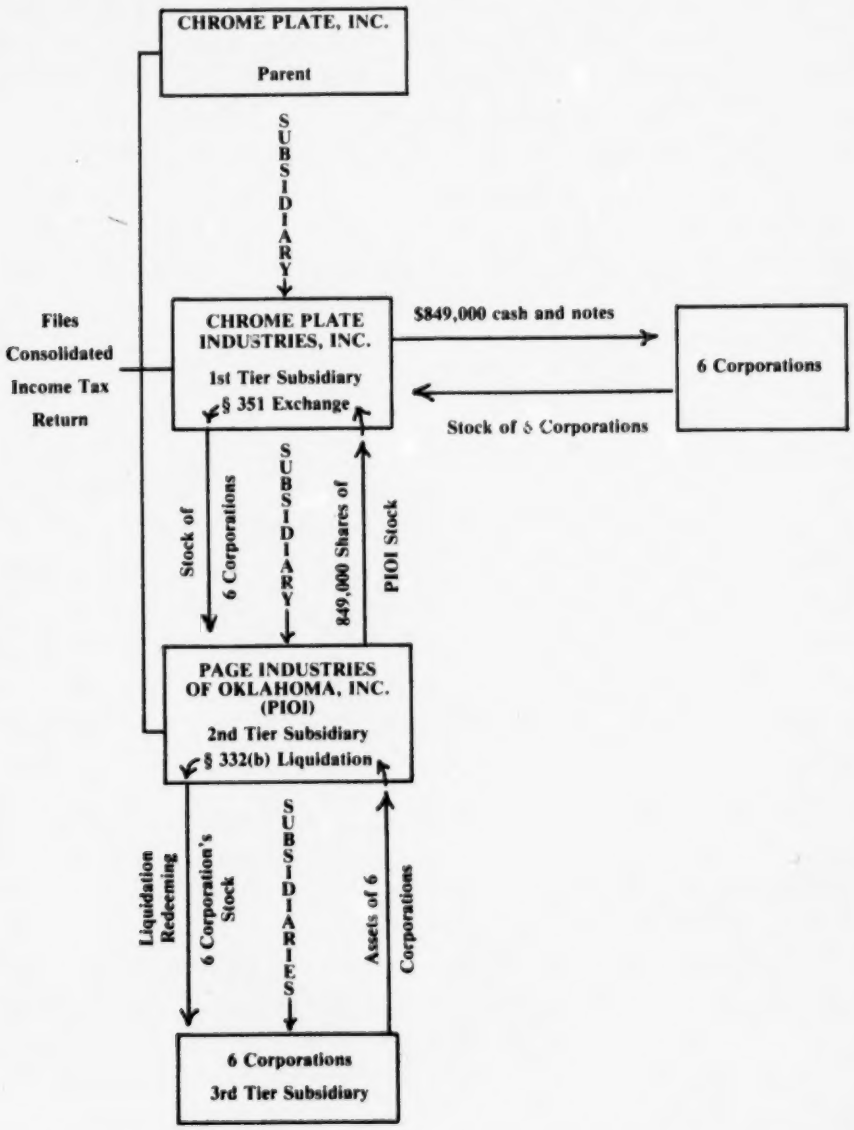
Immediately following the purchase of the stock of the six corporations, Chrome Plate Industries, Inc., transferred the stock to Page Industries of Oklahoma, Inc. (PIOI, second tier subsidiary), in exchange for 849,000 shares of the common stock of PIOI. PIOI was also a newly formed corporation incorporated in December 1972. Upon its incorporation, PIOI had issued 1,000 shares of its stock to Chrome Plate Industries, Inc.; thus, PIOI was a wholly owned subsidiary of Chrome Plate Industries, Inc., which is a wholly owned subsidiary of Petitioner. On December 29, 1972, the six corporations were liquidated, and PIOI succeeded to their assets. The plan was structured for PIOI to receive the liquidated assets instead of Petitioner for two business considerations not for tax reasons. First, the liquidated assets were inventory. If Petitioner had received the assets, they would have been commingled with Petitioner's other inventory. The sellers demanded that their notes be collateralized by the unsold assets acquired from them. Therefore, a cumbersome release procedure would have been required each time Petitioner wanted to sell some of the acquired assets, unless the assets were separated and identifiable. Second, a multimillion dollar law suit was pending against one of the six corporations at the time of the transaction. The Petitioner feared that if the suit had been successful, Petitioner, as the parent corporation, might have been found liable.

The series of transactions described above all occurred within twenty-four hours.

Upon liquidating the six corporations, the Petitioner stepped up the basis of the assets in these corporations to $850,000, the cost of the stock, from their cost basis in the hands of the six corporations. The Internal Revenue Service denied the stepped-up basis in the assets received from the six corporations, and determined that the basis of the assets in the hands of the Petitioner was the same as their basis in the hands of the six corporations. The Internal Revenue Service reached this conclusion because it determined that PIOI (second tier subsidiary) received the stock

of the six corporations from Chrome Plate Industries, Inc. (first tier subsidiary) in a transaction to which Section 351 of the Internal Revenue Code of 1954 (26 U.S.C.) *infra*, applied.

The series of corporate transactions described above may be illustrated as follows:



2. COURSE OF PROCEEDING AND DISPOSITION IN COURTS BELOW

In June of 1974, Petitioner filed a claim for refund of taxes based upon a net operating loss carryback from the end of December 31, 1973. In February of 1975, Petitioner filed under Chapter XI of the Bankruptcy Act. In November of 1976, the Director of Internal Revenue filed a claim in the Bankruptcy Court alleging a deficiency in income taxes and a recoupment of tentative over assessment previously allowed as a result of Petitioner's carryback filed in June of 1974. In April of 1977, Petitioner filed a Motion for Partial Summary Judgment requesting a denial of the claim for refund. The government filed a Motion for Partial Summary Judgment in opposition to Petitioner's Motion for Summary Judgment. The case was argued before the Bankruptcy Court on June 13, 1977, with the Bankruptcy Judge ruling in favor of the Petitioner, relying primarily on *American Potash and Chemical Corporation v. United States,* 399 F.2d 194 (Ct.Cl. 1968). The government appealed the decision and on November 4, 1977, the District Court, without hearing oral argument, reversed the Bankruptcy Court, with instructions to allow the government's claim for income taxes stating that "the Bankruptcy judge. . . simply ignored the Code and applied Pre-1954 Internal Revenue Code Case-Law to the transaction and held for the Plaintiff." In concluding, the District Court held that the *Kimbell-Diamond* doctrine has been supplanted by § 334(b)(2) and therefore applied only to those transactions that satisfy the requirements of that provision. The petitioner appealed the District Court's decision to the United States Court of Appeals for the Fifth Circuit and, on April 2, 1980, in a lengthy opinion, the Fifth Circuit affirmed the decision of the District Court.

REASONS FOR GRANTING THE WRIT

1. This case merits review by this Court on Certiorari because the decision of the Court of Appeals is in direct conflict with the holding of the Court of Claims in *American Potash and Chemical Corporation v. United States*, 399 F.2d 194 (Ct.Cl. 1968). In *American Potash and Chemical Corporation v. U.S.*, the Court of Claims stated the following:

> The question before us is whether Congress intended to preempt the subsequent use of the step transaction doctrine by enacting § 334(b)(2). We find that it did not intend to eliminate the *Kimbell-Diamond* doctrine.
>
> * * *
>
> The *Kimbell-Diamond* doctrine, without question, remains viable for individual taxpayers because § 334(b)(2) is applicable only to corporate taxpayers. We cannot conclude that Congress intended to differentiate between corporate and individual taxpayers and permit the use of the judicial *Kimbell-Diamond* doctrine by an individual who has acquired stock during a period in excess of 12 months, and to deny its application to a corporate taxpayer under the same circumstances. There is nothing in the legislative history to indicate that this anomaly was intended. In the absence of some specific direction that *Kimbell-Diamond* is no longer viable, we find that it has not been preempted by § 334(b)(2).
>
> * * *
>
> Moreover, where Congress intends to modify or change an existing judicial rule, it generally makes some statement of its purpose for enacting a particular statute.
>
> We cannot infer that Congress had any intent other than to establish a precise rule under which a taxpayer could proceed, assured that the cost basis of its stock acquired to obtain the assets would become the basis

of the assets when they were received in the subsequent liquidation. *We conclude that the Kimbell-Diamond doctrine has not been preempted.*" [Emphasis supplied.]

The Fifth Circuit ruled in the instant case the following:

> We hold positively and conclusively that the *Kimbell-Diamond* doctrine is abolished in regard to corporate taxpayers, and the only opportunity to receive a cost basis in complete liquidation of a subsidiary is by fully complying with § 334(b)(2).

2. This case merits review by this Court on Certiorari because if the District Court decision is allowed to stand, taxpayers may enter into a transaction identical to the steps taken in the instant case and receive an unpaid for tax basis in assets in direct conflict to the principles of the *Kimbell-Diamond* doctrine. Surely Congress did not pass § 334(b)(2) to allow a taxpayer benefits which are in direct conflict with the *Kimbell-Diamond* doctrine if the stated intent of Congress was to effectuate the principles of that doctrine.

ARGUMENT

PETITIONER'S BASIS IN THE ASSETS RECEIVED FROM THE LIQUIDATION OF SIX CORPORATIONS SHOULD BE EQUAL TO THE COST OF ACQUIRING THE STOCK OF THE SIX CORPORATIONS.

The question presented in this case involves the basis to be assigned certain assets acquired by Petitioner on liquidation of the six corporations, which had become its wholly owned subsidiary corporation. Petitioner contends that it is entitled to a stepped-up basis in the assets equal to the cost of acquiring the stock of the six corporations, or $850,000. The Government contends that the Petitioner must carry over the six corporation's basis in the assets, or approximately $250,000. The denial of a cost of stock basis of the assets is inconsistent with the intent of

Congress as well as inconsistent with the tax treatment of the shareholders of the six corporations, who reported the transaction as a taxable event and paid tax on the gain resulting from the sale of the stock of the six corporations.

The passage of Internal Revenue Code § 334(b)(2) was an effort by Congress to create parity between the direct acquisition of assets from a corporation and the purchase of stock of a corporation and immediately liquidating that corporation for the purpose of acquiring its assets. In a line of pre-1954 cases, the Courts formulated two basic tax concepts, each of which were established and successfully argued by the Internal Revenue Service. The first concept is known as the substance over form doctrine and was promulgated by *Commissioner v. Court Holding Co.*, 45-1 U.S.T.C. ¶ 9125, 324 U.S. 331; 65 S.Ct. 707 (1945). The doctrine basically requires the Court to view a series of transactions as a whole without giving independent tax significance to the individual steps of the transaction. In 1950, the Tax Court held in *Kimbell-Diamond Milling Co. v. Commissioner, Supra*, that for tax purposes, if a taxpayer engages in a series of step transactions, one must disregard the various steps taken and look to the substance of the transaction. Although the *Kimbell-Diamond* decision reached an equitable result based on the facts of that case, it created confusion as to the state of the law because of the subjective intent required to be proven by the taxpayer. Because of the amount of litigation resulting from the judicially created subjective intent test, taxpayers requested Congress to pass a law providing definite rules relating to the tax treatment of liquidations of subsidiary corporations. In 1953, at hearings of the Committee on Ways and Means, House of Representatives, 83rd Congress, 1st Session, the American Bar Association, as part of its testimony, addressed the question of corporations being able to purchase the stock of other corporations, immediately liquidating those corporations, and being able to allocate the cost of the stock to the assets acquired. Part of its testimony as reported in General Revenue Revision, at Page 1321, states:

The problem is intensified by the fact that corporations are often unwilling to sell their assets because the gain would be subject to a double tax and since their shareholders are unwilling to liquidate the corporation and then sell the assets because of their fear of violating the doctrine of *Court Holding Company* case (324 U.S. 331), a corporate purchaser often finds it necessary to buy the stock of a corporation in order to acquire its assets. The law should provide a definite rule as to tax treatment of a transaction of this type.

RECOMMENDATION: Provide that § 112(b)(6) of the Internal Revenue Code shall be generally applicable regardless of the purpose for which the transferor's stock was acquired, but permit taxpayers to elect to treat § 112(b)(6) as inapplicable if the liquidation occurs within one year after the stock of the transferor is acquired, and provide that § 112(b)(6) shall not be applicable if the acquisition of the stock of the transferor results in a *non-recognition of gain* under § 112(f) of the Internal Revenue Code.

Other testimony before the Committee relating to the *Kimbell-Diamond* doctrine requested the same thing in a set of rules, that if followed would assure the taxpayer a cost of stock basis in the assets.

It appears clear from the testimony at the hearings of the Committee for Ways and Means that taxpayers were requesting Congress to pass legislation providing a way where they could be assured of the tax consequences before entering into a transaction. Congressional intent can be shown in the following House and Senate Reports. *See* House Report No. 2543, 83rd Congress, 2nd Session, which states at Page 36:

(c) *Basis of assets received and liquidation of subsidiaries* - The accompanying Conference Report contains an amendment to § 334(b)(2). Under § 334(b)(2) which relates to the so-called *Kimbell-Diamond* problem, a parent corporation which liquidates its

subsidiary (the stock of which was purchased within the time and in the manner prescribed) receives the assets of the subsidiary on the same basis at which the parent held the subsidiary stock, . . .

The accompanying Committee Report (House Report 1337, 83rd Congress, 2nd Session) states at Page 38:

> Moreover, under the bill, a shareholder will in general be permitted to receive the purchase price for his stock as his basis for the assets distributed to him in liquidation irrespective of the assets cost to the corporation. In this respect, the principle of *Kimbell-Diamond Milling Co.* (187 F.2d 718) is effectuated.

Also, *See* Senate Report No. 1622, 83rd Congress, 2nd Session, which states at Page 48:

> Under the House Bill, a shareholder would in all cases be permitted to receive the purchase price for his stock as his basis for the assets distributed to him regardless of the assets cost to the corporation. In this respect the principles of *Kimbell-Diamond Milling Co.* (187 F.2d 718) are effectuated. Since the application of the rule of this case is presently in the area of liquidation by a parent corporation of the subsidiary, the rule has been limited by your Committee to liquidations of this type. Accordingly, your Committee has provided that where a corporation purchases stock of another corporation and within two years after the purchase a plan of liquidation is adopted, the basis of the assets of the subsidiary received by the parent will be the amount paid for the subsidiary stock.

In determining why Congress excluded a § 351 transactions from the term "purchase" as it applies to § 334(b)(2) one must look to Senate Report No. 1622, 83rd Congress, 2nd Session, at Page 257 which states in part:

> Paragraph (2) of Subsection (b) incorporates into your Committee's bill rules effectuating principles derived from *Kimbell-Diamond Milling Co.*

> Paragraph (2) accordingly provides that if property is received by a corporation in a distribution in complete liquidation of its subsidiary then, provided the conditions of this paragraph are met, the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made.
>
> Paragraph (3) defines the term "purchase" to mean any acquisition of stock but only if the requirements of subparagraph (A), (B), and (C) are met.
>
> Subsection (B) makes clear that stock acquired in an exchange to which § 351 applies does not constitute stock acquired by purchase.
>
> *In general, your Committee intends to limit the definition of the term "purchase" to cases where the acquisition of the stock was made in a taxable transaction.* [Emphasis supplied]

It is clear from the above that Congress reacted to the request of the taxpayers in enacting § 334(b)(2). § 334(b)(2) provides a set of rules under which, if followed exactly, guarantees the taxpayer a cost-of-stock basis of assets acquired through the liquidation of a subsidiary. However, Congress did not state that § 334(b)(2) was the exclusive way to receive a step-up in basis. This was acknowledged by the United States in its brief filed in the District Court below at Page 18:

> Conceitedly, the Committee reports fail to state expressly that § 334(b)(2) was to be the exclusive means by which a distribution was to obtain a cost-of-stock basis for the assets received in a corporate liquidation.

The petitioner agrees with the government in its position that if a taxpayer meets all the requirements of § 334(b)(2) it will receive a cost-of-stock basis irrespective of intent of the taxpayer. However, the petitioner does not agree with the government's position that it is the *exclusive* avenue to qualification for cost-of-stock basis. A comprehensive analysis of the Senate and House Reports indicate that

§ 334(b)(2) was enacted to *effectuate* the *principles* of the *Kimbell-Diamond* doctrine. Both the House and Senate Committees recognized the validity of the tax doctrine created in that decision. It would be inconsistent for Congress then to eliminate that doctrine by the passage of a narrowly defined law. Furthermore, the position take by the government in this case is inconsistent with Revenue Rulings issued in 1967 and 1974. Although Revenue Ruling 67-274 makes no reference to the *Kimbell-Diamond* doctrine specifically, the holding that the initial acquisition of stock is to be disregarded as transitory and that the transaction is to be treated as an acquisition of assets, represents an application of the principles of the *Kimbell-Diamond* doctrine. Further, Revenue Ruling 74-35 acknowledges the validity of those principles. The petitioner believes that the Internal Revenue Service would not cite the principles in later Revenue Rulings if it believed the doctrine was supplanted by § 334(b)(2) and did not survive the enactment of that Section.

The petitioner believes that Congress enacted § 334(b)(2) to insure taxpayers of a method of receiving a cost-of-stock basis for assets received in a corporate liquidation. However, Congress wanted to place safeguards within § 334(b)(2) so that taxpayers could not take unjustified tax advantage of that Section. Therefore, Congress passed § 334(b)(2) which defines "purchase" of stock for purposes of § 334(b)(2). Congress obviously intended to require the parent corporation to purchase stock of a subsidiary from an unrelated person in a transaction which is taxable to the seller. This is exactly what happened in the instant case. The Petitioner believes that in the specific circumstances of this case it has effectively met all of the requirements of § 334(b)(2) Congress intended in order to receive a cost-of-stock basis. It is hard to believe that Congress passed a law which would effectively trap the unwary and limit achieving a cost-of-stock basis if the requirements that Congress intended have been met.

The first case to address the issue of Congressional intent as it relates to the *Kimbell-Diamond* doctrine and § 334(b)(2) was *American Potash and Chemical Corporation v. U.S.*, 399 F.2d 194 (Ct.Cl. 1968). It was the only case which had been decided at the time the petitioner entered into the transaction in question. In *American Potash and Chemical Corporation v. U.S.*, the Court of Claims stated the following:

> The question before us is whether Congress intended to preempt the subsequent use of the step transaction doctrine by enacting § 334(b)(2). We find that it did not intend to eliminate the *Kimbell-Diamond* doctrine.
>
> There is no instance in the legislative history where Congress states either that § 334(b)(2) is the exclusive exception to the carryover rule, or that the *Kimbell-Diamond* rule is superseded or, on the other hand, that it is viable.
>
> Obviously Congress intended to inject some degree of certainty into an area of the tax law previously occupied by problems of proving that a taxpayer had the requisite intent. It is not a necessary conclusion therefrom that Congress intended, by establishing an objective route for obtaining a cost basis without the need for proving an intent to acquire assets, to prohibit both the government and taxpayers from further resort to proof of a subjective intent to obtain the assets without the need for proving an intent to acquire assets without complying with the *precise objective tests* of § 334(b)(2). [Emphasis supplied.]

Our examination of the relevant legislative history reinforces our conclusion that *Kimbell-Diamond* is not "dead." The House Report on the 1954 Code, H. Rep. No. 1337, 83rd Cong., 2d Sess. 38 (1954) reads:

> . . . Under the bill a shareholder will in general be permitted to receive the purchase price for his stock as his basis for the assets distributed to him in liquidation irrespective of the assets' cost to the corporation. In this

respect *the principle of Kimbell-Diamond Milling Co.* (187) F.2d 718 (40 AFTR (328)) is effectuated. [Emphasis supplied.]

The Senate Report, however, modified the original House proposal and limited the scope of the section to corporate situations where a corporation purchases the stock of another corporation and within two years after the purchase adopts a plan of liquidation. The House proposal would have made the cost-of-stock basis rule applicable to all taxpayers, both individuals and corporations.

The Senate concluded that its substitute provision "effectuates principles derived from *Kimbell-Diamond Milling Co., supra.*" S. Rep. supra, pp. 38, A109. The principle of § 334(b)(2) is derived from the broader, more general rule of *Kimbell-Diamond*. It is a precise, narrow and objective application of the broader doctrine.

The *Kimbell-Diamond* doctrine, without question, remains viable for individual taxpayers because § 334(b)(2) is applicable only to corporate taxpayers. We cannot conclude that Congress intended to differentiate between corporate and individual taxpayers and permit the use of the judicial *Kimbell-Diamond* doctrine by an individual who has acquired stock during a period in excess of 12 months, and to deny its application to a corporate taxpayer under the same circumstances. There is nothing in the legislative history to indicate that this anomaly was intended. In the absence of some specific direction that *Kimbell-Diamond* is no longer viable, we find that it has not been preempted by § 334(b)(2).

Moreover, where Congress intends to modify or change an existing judicial rule, it generally makes some statement of its purpose for enacting a particular statute.

We cannot infer that Congress had any intent other than to establish a precise rule under which a taxpayer could proceed, assured that the cost basis of its stock

The Fifth Circuit has been faced with the question of the step transaction many times. The Fifth Circuit affirmed the *Kimbell-Diamond* doctrine and has upheld its validity in several cases. The principle was also articulated by the Fifth Circuit in *Georgia Pacific Corporation v. U.S.*, 264 F.2d 61 (5th Cir. 1954), and in *Kanawha Gas and Utility Co. v. Commissioner,* 214 F.2d 685 (5th Cir. 1954), and in 1960, the Court decided *United States v. M.O.J. Corporation,* 274 F.2d 713 (5th Cir. 1960). Although *M.O.J. Corporation* was decided under the 1939 Code, it upheld the validity of the *Kimbell-Diamond* doctrine applied with full vigor to the admitted facts in that case. In Revenue Ruling 60-246, Internal Revenue Service announced that they would follow the decision of the United States Court of Appeals for the Fifth Circuit in *United States v. M.O.J. Corporation,* supra. Thus, once again, the Internal Revenue Service recognized the doctrine of *Kimbell-Diamond* after the passage of the 1954 Code.

The government in its reply brief filed in the District Court below, and the Seventh Circuit in its decision of *Broadview Lumber Company, Inc. v. U.S.*, 40 AFTR 2d 77-5650d (7th Cir. 1977) insinuated that the Fifth Circuit had decided that § 334(b)(2) had preempted the *Kimbell-Diamond* doctrine in *Supreme Investment Corporation v. United States*, 468 F.2d 370 (5th Cir. 1972). The Petitioner is in agreement with the decision of the Fifth Circuit in *Supreme Investment Corporation*, but disagrees with the conclusion of the government and the Seventh Circuit. In fact, the Petitioner believes that the decision in *Supreme Investment Corporation* supported the Petitioner's position. In *Supreme Investment Corporation v. U.S.,* 468 F.2d at 377, the Court states:

> With respect to the receiving corporation, the position of *Supreme* in this case, the statutory rules are even clearer. The liquidation of C.K.S. meets all the requirements of § 334(b)(2). § 334(b)(2) is a codification of the *principles derived* from the decision of the *Kimbell-Diamond Co. [Emphasis supplied.] . . . The*

Kimbell-Diamond case held that a purchase of a corporation stock in order to obtain its assets should be treated as a direct purchase of the assets, with the consequence that the costs of the stock should serve as the basis for the assets. In codifying the *Kimbell-Diamond* rule, Congress made a major change: It substituted a series of objective tests in place of a determination of the taxpayer's subjective intent to obtain corporate assets. § 334(b)(2) is therefore a mandatory rather than an elective provision, and it must apply even in cases where the taxpayer's intent is not to obtain underlying assets of a corporation but to purchase and maintain the corporate structure.

We think that the mandatory and objective provisions of § 334(a)(1), *as applied to this case*, leaves no room for the Commissioner to assert §269 to require *Supreme* to use a carryover basis.

The taxpayer believes its position is identical to that of the Fifth Circuit because it is obvious that the Congressional intent in enacting § 344(b)(2) was to provide a method where the taxpayer would be sure of receiving the tax benefits which it desired. Since C.K.S. met all the requirements of § 334(b)(2), it was entitled to a cost-of-stock basis in the assets as specifically provided for by Congress. Also, in *Supreme Investment Corporation*, the Court cited one of its earlier decisions, *Blueberry Land Co. v. Internal Revenue,* 361 F.2d 93 (5th Cir. 1966), in which it held:

> Each case must be decided on its own merits by examining the form and substance of the transaction and the purpose of the relevant tax provisions to determine whether recognition of the form of the transaction would defeat the statutory purposes. 361 F.2d at 101.

The petitioner believed that the Fifth Circuit had ruled that when the intent of Congress conflicts with the literal reading of the statutes, the interpretation of the statute must be construed so that Congressional intent will

prevail. It should be noted that in *Supreme Investment Corporation*, the government took an opposite position than in the current case. In *Supreme Investment Corporation*, the government argued that despite Supreme's literal compliance with § 334(b)(2), Supreme should be required to use a carryover basis.

The petitioner's conclusions that the Fifth Circuit had not ruled that the *Kimbell-Diamond* doctrine had been abolished before this instant case is verified in the opinion of the Fifth Circuit where in 614 F.2d 990, at 998 states:

> Without making an affirmative decision, the Fifth Circuit seemed to imply that the doctrine was still viable under the 1954 Code in *Griswold v. C.I.R.*, 400 F.2d 427, 431 (5th Cir. 1968).

In *Broadview Lumber Co., Inc. v. U.S.*, 75-2 U.S.T.C. ¶ 9832 (N.D. Ind., 1975), the Court held:

> In arriving at this conclusion, the Court rejects Defendant's position that Congress, in enacting § 334(b)(2) preempted the *Kimbell-Diamond* doctrine. Rather the Court chooses to follow the position of the Court of Claims in *American Potash and Chemical Corporation v. U.S.*, supra, that *Kimbell-Diamond* is still viable despite the enactment of § 334(b)(2).

In its opinion, the District Court followed the rationale of *American Potash and Chemical Corporation.* In August of 1977, the Seventh Circuit overruled the decision of the District Court in *Broadview Lumber Co., Inc, v. U.S.*, supra. However, the petitioner believes that the decision rendered by the Seventh Circuit is consistent with the position of the petitioner. In examining the Congressional intent, the Seventh Circuit stated:

> Throughout the legislative reports accompanying the 1954 Internal Revenue Code, the language used to describe the function of § 334(b)(2) is that it permits the taxpayer to retain as his basis for the distributed assets his cost of acquiring the liquidated corporation's stock. That choice of language indicates that

> Congress viewed *Kimbell-Diamond* as providing taxpayers with a valuable exception to the general rule that the basis of assets acquired by shareholders in liquidation should be carried over from the liquidated corporation. § 334(b)(2) was enacted to clarify when that exception would apply.
>
> As the Tax Court has recognized, Congress has established few guidelines for analysis of integrated or step transactions, and it has generally avoided strict rules due to the practical difficulties of trying to provide for all possible forms of corporate transactions. The Courts have been left to fashion rules responsive to the varied transactions. . . .The mechanical rules of § 334(b)(2) provide a clear method for determining what basis will apply to assets received in liquidation and the most frequently reoccurring fact situations, liquidations of a subsidiary by a parent. It is a solution to a common tax planning problem to lessen the uncertainties surrounding prior tax law.
>
> We hold that the *subjective tests* of *Kimbell-Diamond* are not applicable to the *facts here.* [Emphasis supplied.]

In ruling that § 334(b)(2) did not apply because the stock was acquired from persons to whom § 318(a) applied, the Court stated:

> The Senate Report expressly declared that in general it intended: "to limit the definition of the term 'purchase' to cases where the acquisition of the stock was made in a taxable transaction." Keeping in mind our view that § 334(b)(2) was intended to permit taxpayers to obtain an exception to the general rule of § 334(b)(1), we take that to mean that Congress did not want taxpayers who had acquired assets through stock transactions which *avoided* taxation to be able to take advantage of a step-up basis as well.

In finding for the taxpayer, the Seventh Circuit concluded by saying:

> Finding that the subjective intent test of *Kimbell-Diamond* have been replaced in *certain circumstances* by the objective standards of Section 334(b)(2)....
>
> Also, in a footnote, the Court stated:
>
> Our finding that the close corporation relationship involved herein which precludes Section 334 (b)(2) treatment of cost as basis is consistent with our interpretation of the nature of that section. Because the section will often convey a substantial benefit upon the taxpayer by giving him a stepped-up basis, Congress imposed the attribution rule of Section 318(a) to insure that those benefits are not obtained by artificial transactions between closely related parties or economic interests.

The petitioner concurs with the decision of the Seventh Circuit because it believes that it is consistent with Congressional intent.

In *Baker Commodities, Inc. vs. Commissioner,* 48 T.C.374 (1967), the Tax Court held Baker was not entitled to a step-up in basis of the assets for two reasons: (1) It claimed partnership business was transferred to a corporation in 351 transfer. Although the facts are complicated, it is clear that the Court was correct in its decision because there was no taxable transaction entered into by the transferor and Congress specifically intended in the passage of 334(b)(3)(B) to exclude a step-up in basis of assets when the transferor did not incur a taxable transaction. (2) The Tax Court held that Baker should not be allowed a step-up in basis because the transaction also involved related parties and would be excluded under Section 334(b)(3)(C). The petitioner believes that the decision was also consistent with the intent of Congress.

Also, in *Bijou Park Properties, Inc. vs. Internal Revenue Service,* 47 T.C. 207 (1966), the Court determined that the liquidation in that case did not qualify under Section 334(b)(2) because the stock was purchased from related parties where Section 318(a) applied.

In support of its position, the government cited *Pacific Transportation Co. v. Commissioner,* 483 F.2d 209 (9th Cir. 1973) cert. denied 415 U.S. 948 (1974), and *Boise Cascade Corp. V. United States,* 288 F.Supp. 770 (Idaho, 1969), *aff'd per curiam* 429 F.2d 426 (9th Cir. 1973) in its Reply Brief. The taxpayer contends that neither of these cases is in point with the case at hand. In each case, both parties agree that a Section 334(b)(2) liquidation has occurred. The only question presented in those cases is how to allocate the basis of the assets acquired in the 334(b)(2) liquidation. Further, the government argues that Ninth Circuit rejects any inquiry into the corporation's intent in the acquisition of stock. In the instant case, the petitioner is not asking the Court to determine the intent of the petitioner, but to determine the intent of Congress in passing Section 334(b)(2) and Section 334(b)(3)(B).

The only argument the government presents in not allowing the petitioner to receive a cost-of-stock basis in the assets received in the liquidation is that it does not meet the formal definition of "purchase" in 334(b)(3). However, the petitioner did effectively purchase the stock of the six corporations from independent third parties in a taxable event to the sellers. It is clear that in a transaction such as this, Congress intended the purchaser to receive a step-up in basis of the assets equal to what it paid for the stock.

In determining why Congress excluded a Section 351 transaction from the term "purchase" as it applies to Section 334(b)(2), one must look to Senate Report No. 1622, 83rd Congress, Second Session, at page 257, where it concludes by stating:

> In general, your Committee intends to limit the definition of the term 'purchase' to cases where the acquisition of the stock was made in a taxable transaction.

It is undisputed that Congress intended the term "taxable transaction" to mean that the transaction results in a taxable event to the seller of the stock.

Section 351 provides that gain shall not be recognized if property is exchanged solely for stock or securities of a controlled corporation. The Government insinuates that since one of the steps of the transaction was a Section 351 transaction, the petitioner avoided a taxable transaction and thus received a tax benefit. This is not true. The petitioner merely met the statutory requirements of Section 351 in one of the steps of the transaction. However, it received no tax benefit. If the step of the transaction had not met the requirement of Section 351 and was deemed to be a taxable transaction, no tax liability would have resulted. The tax basis of the property transfer was equal to the fair market value of the property. Therefore, even if a taxable event occurred, there would not have been any gain realized.

In discussing the purchase requirements under § 334(b)(3), Bittker and Eustice state in their section on complete liquidations, paragraph 11.44, that:

> Thus, the statutory *Kimbell-Diamond* rule applies primarily to essentially one shot purchases of stock by the parent corporation from unrelated parties in transactions that as to the sellers, are taxable events (i.e., in which their gain or loss on the transfer is recognized).
>
> * * *
>
> § 334(b)(3) (definition of "purchase") was amended by P.L. 89-809 (1966) to cure the timing problem created by § 334(b)(3)(C) where a chain of subsidiaries was acquired and liquidated into the parent in the wrong order, i.e., where stock of the first tier subsidiary is acquired by purchase, and assets of the second tier subsidiary are ultimately acquired by the purchaser parent corporation after a prior liquidation of the first tier subsidiary. Under this amendment the parent can now liquidate the first tier subsidiary before liquidating the second tier subsidiary and

attain 334(b)(2) treatment with respect to the latter's assets notwithstanding § 334(b)(3)(C).

Prior to this amendment, if the parent liquidated its first tier subsidiary before liquidating the second tier subsidiary, stock of the second tier subsidiary technically could not have been acquired by purchase because of the attribution principles of § 334(b)(3)(C). If the order were reversed, however, § 334(b)(2) would apply to give the parent a step-up in basis for assets of the second tier subsidiary. In order to eliminate this formal distinction, based solely on the order of liquidation of a chain of subsidiaries, § 334(b)(3) was amended to provide that § 334(b)(3) would not apply to the parent's acquisition of the second tier subsidiary stock if it made the qualifying purchase of the first tier subsidiary's stock.

Congress recognized that the formal distinction of the order of liquidation should make no difference as to whether the parent received a cost-of-stock basis because the purchase met all the criteria intended by Congress in order to receive a cost-of-stock basis. The petitioner submits that is exactly the situation in the instant case. The petitioner purchased stock from independent third parties in which the sellers recognized gain. That is the transaction that Congress intended in order to get a cost-of-stock basis. Had the steps of the transaction of the petitioner been changed only slightly, with no effect of the end result at all, there would be no argument that it is entitled to a cost-of-stock basis. Congress recognized one problem and corrected it in 1966. The petitioner believes that if Congress corrected the mere formal distinction in the liquidation of a chain of subsidiaries, it would do the same in a situation identical to the one presented by the petitioner.

In support of its position in this case, the government cited as authority, on page 17 of its Brief filed in the District Court, the following:

> The results which attains herein denying a stepped-up basis in the liquidating corporation's assets by reason of the failure to meet 'purchase' requirements of § 334(b)(2), has also been contemplated by

commentators who have warned against structuring such transactions in a manner which Plaintiff adopted. See *Barnovitz, Problems in Achieving Parity in Tax Treatment under Sections 337 and 334(b)(2),* 34 N.Y.U. Institute of Federal Taxation, 57, 110, 1976.

Although Barnovitz warns of a potential attack by the Internal Revenue Service on structuring a transaction in the manner the petitioner adopted, the article clearly supports the position of the petitioner. After describing a set of facts identical to the ones in this case, Barnovitz submits that the Internal Revenue Service could argue that a Section 351 transaction had occurred, and therefore, did not meet the purchase requirements of 334(b)(3). He then states that:

> As cases such as *Madison Square Garden Corporation v. Commissioner,* 500 F.2d 611 (2nd Cir. 1974) and *Mary B. Kass v. Commissioner of Internal Revenue,* 60 T.C. 218 (1973), indicate, however, the Courts generally have refused to deny a step-up in basis in the acquired corporation's assets on technical grounds, where such denial would be inconsistent with the tax treatment to the shareholders of the acquired corporation. This position is also illustrated by the recent decision of *YOC Heating Corporation v. Commissioner of Internal Revenue,* 61 T.C. 168 (1973).

In the *YOC Heating Corporation* case, the Internal Revenue Service took the position that the petitioner did not meet the formal requirements of § 334(b)(2) and therefore, should not be allowed a step-up in basis of the assets acquired equal to the purchase price of the stock of the acquired corporations. However, the Court allowed *YOC Heating Corporations* to receive a cost-of-stock basis of the assets of the acquired corporation under the broader principle of the integrated transaction doctrine. The Court did not apply the *Kimbell-Diamond* doctrine, noting that this latter doctrine had been limited to transactions involving the acquisition of the underlying assets of a

corporation by its controlling shareholders. Therefore, it did not decide whether the *Kimbell-Diamond* doctrine had continuing vitality after enactment of § 334(b)(2).

The petitioner contends that the government has cited Barnovitz out of context. A complete reading of the article clearly indicates that Barnovitz fully supports the position of the petitioner. This support is shown in the concluding paragraphs of the article, which state:

> Although the decision of *YOC Heating Corporation* does not deal with the question of a step-up in basis for the acquiring corporation as the "distributee" within the meaning of § 334(b), it does exhibit a judicial reluctance to take a formalistic approach to resolve questions of this nature. *If the acquisition of the acquired corporation's stock is for the purpose of acquiring its underlying assets, and all of the consideration paid for the stock of the acquired corporation is taxable to its shareholders, the acquiring corporation, irrespective of whether or not it meets the literal requirements of* § 334(b)(2), should obtain a step-up in basis in the assets of the acquired corporation. (Emphasis supplied.) It is difficult to envision a court which applies the integrated transaction principle of *YOC Heating Corporation* and refusing to apply the related *Kimbell-Diamond* principle when directly confronted with the issue.
>
> It is noted that the Court of Appeals in *Madison Square Garden Corporation v. Commissioner,* expressed its approval of the Tax Court's decision in *YOC Heating Corporation.*
>
> The position of the Courts on this issue of substance versus form is consistent with the principle of parity between a direct asset acquisition and one pursuant to § 334(b)(2). The Courts have properly refused to make 334(b)(2) a trap for the unwary and thus limit its utility in achieving the step-up in basis and the acquired corporation's assets that inexorably follows from a purchase transaction that is taxable to the shareholders of the acquired corporation.

In the instant case, the petitioner desired to purchase the assets of the six corporations. The sellers refused to sell the assets but would only agree to sell the stock of the corporation with specific collateral restrictions. Therefore, the petitioner purchased the stock for the sole purpose of acquiring the assets of the six corporations in a transaction which was taxable to the sellers of the stock. As acknowledged by the Government in its Brief for The Appellee filed in the Fifth Circuit, at page 15, the *Kimbell-Diamond* doctrine states that a purchaser who, in order to acquire assets, acquires the stock of a company and liquidates it, may substitute his basis in the stock for his basis in the assets. This is exactly what happened in the instant case. The intent of the petitioner to acquire the assets is immediately evident since the petitioner immediately liquidated the six corporations.

The Government argues that even if the rule of *Kimbell-Diamond* did survive the passage of § 334(b)(2), it would not change the results of this case. This conclusion is unsupportable. The doctrine of *Kimbell-Diamond* states that if a purchaser with intent to acquire assets is required to acquire the stock of a company and liquidate it in order to obtain the assets of the company, the basis of the assets should equal the cost of the stock purchased in order to acquire those assets. In the instant case, the seller would not sell the assets of the six corporations but would only sell the stock. The Government has never raised the question as to the intent of the petitioner because it is obvious that the sole purpose of acquiring the stock was to acquire the assets. The petitioner has fully complied with the *Kimbell-Diamond* doctrine and is entitled to a basis of the assets equal to what it paid for the stock.

The Government, in contending that the *Kimbell-Diamond* doctrine should not apply in this case, argues that one must look to the entity that eventually

holds the assets and not to the intent of the petitioner as to why it purchased the stock. The *Kimbell-Diamond* doctrine has nothing to do with which entity owns the assets acquired but merely a question of intent of the petitioner in acquiring the stock. See *United States v. M.O.J. Corporation,* 274 F.2d 713 (5th Cir. 1960).

The Government has taken the position that the petitioner chose the form of the transaction in which it entered into to acquire the stock of the six corporations. This is incorrect. The form of the transaction was dictated by the seller of the stock because of the restrictive collateral requirements insisted upon by the seller. The transaction took the only form under which the seller would sell the stock. After substantial research by the petitioner's certified public accountant and attorney at law, relying on the only case dealing with the *Kimbell-Diamond* doctrine at the time, *American Potash and Chemical Corp. v. United States,* 399 F.2d 194 (Ct. Cl. 1968), and relying on issued Revenue Rulings, it was determined that the petitioner fulfilled all the requirements necessary to receive a cost of stock basis in the assets acquired.

The petitioner has fully complied with all the requirements as intended by Congress to receive a cost of stock basis in the assets. The seller of the stock entered into a taxable transaction which resulted in gain and a tax liability to them. Therefore, *the reason that Congress excluded a 351 transaction from the definition of purchase as it applies to* § 334(b)(2) *is not present in this case.* It was not the intent of Congress to require a taxpayer to lose tax basis which it has paid for and can never recover if it has fulfilled all the requirements as intended by Congress. *In facts such as this, substance over form must prevail so that the intent of Congress is satisfied.*

The Government took the position in the Court below that the step transaction and substance-over-form analysis should apply only to sham transactions or excessively circuitous routes to an end and only those transactions are ignored for tax purposes. It insinuates that if a substance-

over-form analysis benefits the petitioner instead of the Government, the doctrine should not apply. The Government analysis is totally in error. A 1978 Tax Court case held in ruling for the petitioner the following:

> In the case before us, although the formal structure of the transaction is different, the net result is the same. To reach a different result in the case before us, merely because the transaction was not so artfully arranged, would be to exalt form also produces capricious results; in cases which are not substantially different, courts are led to reach differing results. . . If we focus instead on the substance of the transactions, taking into consideration all steps which are part of an integrated plan, we reach results which are consonant with legislative purpose and which treat all taxpayers evenhandedly. *Franklin B. Biggs v. Commissioner of Internal Revenue,* 69 T.C. No. 78, 1978.

It is an undisputable fact that by passing Section 334, Congress intended to effectuate the principles of the *Kimbell-Diamond* doctrine. Presumably, Congress intended that the Government would enforce that Section in accordance with those principles.

In the instant case, the petitioner purchased the stock of the six corporations for $850,000, liquidated them on the same day, and assigned to the assets acquired (inventory of used aircraft engines and parts) the $850,000 cost of the stock. When the *Kimbell-Diamond* doctrine is applied to this transaction, it is unrefutable that the petitioner is entitled to a basis in the assets equal to his cost of the stock or $850,000.

If this court rules in favor of the Government's argument, one need only to change the value of the carryover basis of the assets to see how taxpayers can take unjust advantage of the ruling. Assume that the carryover basis of the assets acquired had been $1,450,000 instead of $250,000. Following the theory of the Government, the petitioner should be entitled to a basis in the assets acquired of $1,450,000. This interpretation of

congressional intent would give the taxpayer an unpaid-for tax benefit of $600,000, i.e., a tax basis of $1,450,000 for which the taxpayer paid $850,000. In attempting to deny the petitioner in this case its rightful and equitable cost basis in the assets acquired, the Government is failing to follow the intent of Congress in effectuating the principles of the *Kimbell-Diamond* doctrine. It is, in fact, attempting to destroy the doctrine completely.

CONCLUSION

The petitioner has met all the requirements that were intended by Congress in order to obtain a cost-of-stock basis. The petitioner is not receiving any unwarranted or unpaid for tax benefit. It entered into an argreement to purchase stock of six corporations from unrelated third persons which was a taxable transaction to the sellers. It purchased the stock for the sole purpose of acquiring the assets and liquidated the corporations the same day in order to get at the assets.

Therefore, the petitioner respectfully requests the Court to reverse the decision of the District Court and affirm the decision of the Bankruptcy Court in allowing the petitioner a cost-of-stock basis in the assets which are the subject of this case and deny the claim by the Internal Revenue Service for federal income tax.

APPENDIX A

In the Matter of CHROME PLATE, INC., Bankrupt.

CHROME PLATE, INC., Appellant

v.

DISTRICT DIRECTOR OF INTERNAL REVENUE, United States of America, Appellee

No. 77-3402.

United States Court of Appeals, Fifth Circuit

April 2, 1980

Appeal from the United States District Court for the Western District of Texas.

Before AINSWORTH, INGRAHAM and GARZA, Circuit Judges.

GARZA, Judge:

In this case, the court must determine two issues. First, we must decide whether the corporate taxpayer herein qualifies for a cost basis under 26 U.S.C. § 334(b)(2). Second, the court is presented with the question of whether a certain judicially created rule under the 1939 Internal Revenue Code, known as the *Kimbell-Diamond* doctrine, retains continuing viability under the 1954 code. We resolve both issues in the negative.

The present situation concerns the acquisition of six aircraft businesses owned or controlled by Clarence E. Page and the subsequent tax consequences. In 1972, the Appellant, Chrome Plate, Inc. [Chrome Plate] was a corporation engaged in the business of chrome plating aircraft cylinders. The six corporations [the Page corporations] were engaged in the sale and repair of airplanes and airplane engines. On December 12, 1972,

Page Industries of Oklahoma, Inc. [PIOI] was created. On December 15, 1972, Chrome Plate Industries, Inc. [CPI] was formed which was a wholly owned subsidiary of Chrome Plate. Shortly thereafter, PIOI issued 1,000 shares of its stock to CPI. On December 28, 1972, all of the stock in the Page corporations was transferred to CPI.[1] In return for the stock, CPI paid $850,000 in cash and notes.

Immediately after the acquisition of the Page corporations stock, CPI transferred the Page corporations stock to PIOI in exchange for 849,000 shares of PIOI common stock. This transaction rendered PIOI a wholly owned subsidiary of CPI. The following day, December 29, 1972, the Page corporations were liquidated, and PIOI succeeded to their assets.

Upon the liquidation, PIOI stepped up the basis of the acquired assets from their original cost of Page[2] to the cost of PIOI of $849,000. Chrome Plate filed a consolidated income tax return with CPI and PIOI for the taxable year 1973. Following the filing in bankruptcy by Chrome Plate in 1975, the Internal Revenue Service [IRS] claimed that Chrome Plate's basis in the Page corporations' assets should have been the same as the basis in the Page corporations stock.[3] On cross motions for partial

1. An individual named O.J. Butts owned 20% of the stock in one of the corporations, Page Air Parts, Inc. He, too, transferred his stock to CPI as part of the instant transaction. Thus, after the CPI-Page corporations transaction, CPI owned all of the stock of the Page corporations.

2. In the instant case, the basis of the stock in the hands of the Page corporations was approximately $250,000.

3. The facts leading to the institution of the IRS's claim are a bit more detailed. CPI had apparently sold some of the assets from the Page corporations, which possessed the stepped-up basis. In its consolidated 1974 income tax return, Chrome Plate filed a claim for refund of taxes based upon a net operating loss carryback from the year ended December 31, 1973. In 1975, Chrome Plate filed under Chapter XI of the Bankruptcy Act. In November of 1976, the IRS filed a claim in bankruptcy court alleging a deficiency in income taxes. The IRS alleged that the net operating loss carryback should

summary judgment regarding the basis of the Page corporations stock, the bankruptcy judge ruled in favor of Chrome Plate. On appeal to the district court, the decision of the bankruptcy judge was reversed. *Chrome Plate, Inc. v. District Director of Internal Revenue,* 442 F.Supp. 1023 (W.D.Tex.1977).

I. THE BASIS UNDER THE INTERNAL REVENUE CODE

26 U.S.C. § 331(a)(1) provides the general rule regarding a complete liquidation of a corporation. § 331(a)(1) states:

> Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

26 U.S.C. § 1001(c) provides that the entire amount of the gain or loss on the sale or exchange of stock shall be recognized except in certain situations. *See* B. Bittker & J. Eustice, Federal Income Taxation of Corporations and Shareholders ¶ 11.40, at 11-30 (4th ed. 1979) [hereinafter Bittker & Eustice]. One of the exceptions to § 1001(c), which is applicable in this case is 26 U.S.C. § 332. If the conditions of § 332 are met, the parent corporation will realize no gain or loss on the receipt of property distributed in complete liquidation of a subsidiary.[4] To

be decreased because Chrome Plate claimed an incorrect basis regarding the Page corporations transaction in 1973. The IRS also sought a recoupment of tentative overassessment allowed as a result of the carryback filed in 1974. The recoupment claim regarding an allegedly bad debt claim is not before this court. The only issue before the court concerns the basis in the Page corporations stock.

4. This transaction, where a subsidiary is liquidated into a parent, is also called an "upstream merger." The rationale for the granting by Congress of this tax status was that statutory mergers are given such a status. Since a § 332 type of transaction amounts to a "practical" or "upstream" merger, Congress bestowed upon it the same benefits given to statutory mergers. *See* Bittker & Eustice ¶ 11.40, at 11-31.

qualify, a parent corporation[5] must possess at least 80% of the total combined voting power of all classes of stock and own at least 80% of the total number of shares of all other classes of stock. 26 U.S.C. § 332(b)(1). The distribution by the subsidiary must be in complete cancellation or redemption of its stock, and a complete transfer must occur within the taxable year. 26 U.S.C. § 332(b)(2). Finally, the distribution must be made pursuant to a plan of liquidation under which the transfer of all the property be completed within three years from the close of the taxable year during which the first of any series of distributions is made. 26 U.S.C. § 332(b)(3).

The basis provisions applicable to § 332 transactions are found in 26 U.S.C. § 334. The general basis utilized upon a liquidation of a subsidiary under § 332 is a carryover, *i.e.*, the basis of the property in the hands of the parent shall be the same as it would be in the hands of the subsidiary. 26 U.S.C. § 334(b)(1).[6] § 334(b)(1) provides for one exception to the above basis rule, which is found in § 334(b)(2).[7] *See Cabax Mills v. C.I.R.*, 59 T.C. 401, 406

5. The pertinent statutes speak in terms of the receiving corporation (the distributee) and the distributing corporation, rather than "parent" and "subsidiary." For purposes of clarity, however, the latter two terms will be used in this opinion.

6. § 334(b)(1) provides as follows:

> In general.—If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), then, except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor. If property is received by a corporation in a transfer to which section 332(c) applies, and if paragraph (2) of this subsection does not apply, then the basis of the property in the hands of the transferee shall be the same as it would be in the hands of the transferor.

7. § 334(b)(2) provides in pertinent part as follows:

> (2) Exception.-If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), and if—
>
> (A) the distribution is pursuant to a plan of liquidation adopted not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(1972); *Bijou Park Properties, Inc. v C.I.R.* 47 T.C. 207, 214 (1966). When applicable, the exception allows the parent corporation to take a cost basis in the property as opposed to a carryover basis. In other words, under the exception to § 334(b)(1), the basis of the property in the hands of the parent will be equal to the cost of the stock purchased with certain possible adjustments.[8]

A cost basis under § 334(b)(2) may be used if certain requirements are met regarding property received by a corporation in a distribution in complete liquidation of another. The parent corporation must acquire by purchase stock of the subsidiary possessing at least 80% of the total voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all other classes of stock during a twelve month period, beginning with the date of the first purchase of stock. § 334(b)(2)(B)(i). The distribution must be made pursuant to a plan of liquidation adopted not more than two years after the date of the above transaction. § 334(b)(2)(A).

> (B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a 12-month period beginning with the earlier of—
> (i) the date of the first acquisition by purchase of such stock, or
> (ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation from which such acquisition was made, then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made.

8. The regulations under § 334(b)(2) list the adjustments that must be made in reaching the parent's final adjusted basis. *See* Int.Rev.Regs. § 1.334-1(c)(4). The purpose for these adjustments is to place the party in the same basis position as if that party had liquidated immediately after acquiring the stock. *See* Bonovitz, *Problems in Achieving Parity in Tax Treatment Under Sections 337 and 334(b)(2),* N.Y.U. Proc. of the 34th Inst. on Fed. Tax 57, 89 (1976) [hereinafter Bonovitz]. In the present case, however, the issue of adjusted basis is not present.

The need for a "purchase" under § 334(b)(2) is to insure that a taxable transaction has occurred. In other words, Congress in enacting § 334(b)(2) did not want to allow corporate taxpayers who had acquired assets through transactions which avoided taxation to also receive the benefits of a stepped-up cost basis. *See Broadview Lumber Co., Inc. v. United States,* 561 F.2d 698, 713 (7th Cir. 1977); Bittker & Eustice ¶ 11.44, at 11-44. The term "purchase", as used in § 334(b)(2)(B), is defined in § 334(b)(3) as any acquisition of stock except in three circumstances. For present purposes, only one of these circumstances is applicable. The term "purchase" does not include a transaction in which the stock is "acquired in an exchange to which [26 U.S.C.] section 351 applies . . ." § 334(b)(3)(B).

26 U.S.C. § 351 provides that:

> No gain or loss shall be recognized if property is transferred to the corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in § 368(c)) of the corporation.

26 U.S.C. § 368(c) defines the term "control" as the ownership of stock possessing at least 80% of the total combined voting power of all classes of stock entitled to vote and at least 80% of the total number of shares of all the classes of stock of the corporation.

Thus, a corporate taxpayer may receive a cost basis in liquidated assets merely by following the dictates of § 334(b)(2). It is a completely objective test in which the intent of the receiving corporation is immaterial. *See Broadview Lumber Co, Inc. v. United States,* 561 F.2d at 711; *Boise Cascade Corporation v. United States,* 288 F. Supp. 770, 774 (D.Idaho 1968), *aff'd per curiam,* 429 F.2d 426 (9th Cir. 1970); Bittker & Eustice ¶ 11.44, at 11-48. If a corporate transaction complies with the provisions of § 334(b)(2), it receives a cost basis. Otherwise the transaction falls back under § 334(b)(1), and the parent obtains a

carryover basis.

The transfer of cash and notes by CPI for the stock of the Page corporations clearly qualified as a "purchase" as defined in § 334(b)(3). The sellers of the Page corporations stock clearly realized a gain upon that sale. It was the next step taken by CPI which tainted the transaction and caused this litigation.

The parties in this case concede and the trial court found that the exchange of the Page corporations stock for the PIOI stock qualified as a § 351 transfer. The control requirements were satisfied, and there was no actual generation of income for either party. *See E. I. DuPont de Nemours and Company v. United States,* 471 F.2d 1211, 1214, 200 Ct.Cl. 391 (1973). Since the term "property" encompasses whatever may be transferred, *see Hempt Bros., Inc. v. United States,* 354 F.Supp. 1172, 1175 (M.D.Pa.1973) *aff'd,* 490 F.2d 1172 (3d Cir. 1974), *cert. denied,* 419 U.S. 826, 95 S.Ct. 44, 42 L.Ed.2d 50 (1974), this court agrees that the stock for stock exchange between CPI and PIOI qualified as a § 351 transfer.

The Appellant has suggested to this court that it disregard the § 351 exchange as superfluous to the overall transaction. This court may not do so. To qualify under § 334(b)(2), there must be strict compliance with its requirements. The Appellant argues correctly that if CPI had received the liquidated assets directly from the Page corporations, the transaction would have qualified under § 334(b)(2). This court, however, may not ignore the form of the transaction deliberately chosen by the taxpayer.[9] *See Yoc Heating Corporation v. C.I.R.,* 61 T.C. 168, 175 (1973).

9. In its briefs and in the record in the court below, the reasons for the inclusion of the § 351 transfer in the transaction are never made clear. The asserted rationale was that it had been structured to fulfill the business and tax needs of all parties involved. At oral argument, counsel for Chrome Plate was asked why PIOI had received the liquidated assets rather than CPI. Counsel informed the court that Appellant did so for two reasons. First, counsel stated that the liquidated assets were inventory. Counsel went on to explain that if CPI had received the assets, they would have been

Although CPI acquired the stock by purchase, CPI could no longer be regarded as the acquiring corporation following the § 351 transfer. At that point, PIOI rather than CPI acquired the liquidated assets. There is no doubt that PIOI satisfied the time limit and stock ownership requirements of § 334(b)(2). PIOI did receive property "in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)) . . ." 26 U.S.C. § 334(b)(2). Nonetheless, PIOI, the receiving corporation, acquired the stock "in an exchange to which section 351 applies . . ." 26 U.S.C. § 334(b)(3)(B). Under a clear reading of the statute, neither CPI nor PIOI qualify under § 334(b)(2).

Appellant also argues that PIOI, CPI and itself should be regarded as a single entity since a consolidated income tax return had been filed. The filing of such a return, however, is insufficient to destroy the separate existence of the corporations. As long as a corporation conducts some type of business activity, it remains a separate taxable entity. *See Moline Properties, Inc. v. Commissioner,* 319 U.S. 436, 438-39, 63 S.Ct. 1132, 1133-1134, 87 L.Ed. 1499 (1943). A parent corporation possesses a separate existence and is treated separately from a subsidiary unless there are circumstances justifying disregard of the corporate entity. *See Evans v. C.I.R.*, 557 F.2d 1095, 1099 (5th Cir. 1977). *See also Western Beef, Inc. v. Compton Investment Co.*, 611 F.2d 587 at 590 (5th Cir. 1980) (a division of a corporation is not a separate legal entity, apart from the corporation, but a subsidiary corporation is separate); *Walker v. Newgent,* 583 F.2d 163, 167 (5th Cir. 1978), *cert. denied,* 441 U.S. 906, 99 S.Ct. 1994, 60

commingled with CPI's other inventory. Counsel argued that it then would have been difficult to procure a release every time CPI wanted to sell some of the acquired assets. Second, counsel stated that a multimillion dollar law suit had been pending against one of the Page corporations at the time. Appellant feared that if the suit had been successful, CPI, as the parent, could have been found liable. This court accepts the above reasons as true and assumes that CPI possessed legitimate purposes for the transaction.

L.Ed.2d 374 (1979) (fact that parent corporation owned 100% of subsidiary's stock is not sufficient by itself to merge the two for purposes of establishing an agency relationship). In order to disregard the corporate entity, there needs to be a showing that separativeness of functions was not maintained. *See Quarles v. Fuqua Industries, Inc.*, 504 F.2d 1358, 1362 (10th Cir. 1974). Such a showing does not exist here. There has been no contention that the three corporations did not carry out separate functions nor that any of them was not created for valid business reasons.

Thus, under the requirements of § 334(b)(2), the Appellant as well as its subsidiaries have failed to qualify. Regardless of the Appellant's reasons for structuring the transaction as it did, it has not complied with the cost basis exception in § 334, and under the statute it must receive a carryover basis.

II. THE KIMBELL-DIAMOND DOCTRINE

The Appellant also raises the claim that this court has the right to ignore the transitory steps of the instant transaction and allow the taxpayer a cost basis based upon his intent to acquire the assets of the Page corporations. For this proposition, Appellant relies upon *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T.C. 74 (1950), *aff'd per curiam,* 187 F.2d 718 (5th Cir. 1951), *cert. denied,* 342 U.S. 827, 72 S.Ct. 50, 96 L.Ed. 626 (1951). The *Kimbell-Diamond* doctrine provided that when a taxpayer, solely interested in acquiring a corporation's assets, purchased stock and then liquidated the acquired corporation, the

transaction would be viewed as a purchase of assets and the various steps would be considered a single transaction.

The *Kimbell-Diamond* doctrine was created to correct an inequity in the 1939 Internal Revenue Code. In the 1939 code, § 332's predecessor was found in 26 U.S.C. § 112(b)(6) and was very similar to the present provisions. The basis provision for § 112(b)(6), however, provided in pertinent part that:

> If the property was received by a corporation upon a distribution in complete liquidation of another corporation within the meaning of section 112(b)(6), then the basis shall be the same as it would be in the hands of the transferor.

26 U.S.C. § 113(a)(15).

There was no counterpart to the present § 334(b)(2) in the 1939 code. Thus, under the old code, an acquiring corporation was forced to take a carryover basis in the assets, regardless of the price paid for the distributing corporation's stock. *See Cabax Mills v. C.I.R.*, 59 T.C. 401, 408 (1972). The seeds of *Kimbell-Diamond* were sowed in *C.I.R. v. Ashland Oil & Refinery Co.*, 99 F.2d 588 (6th Cir. 1938), *cert. denied,* 306 U.S. 661, 59 S.Ct. 786, 83 L.Ed. 1057 (1939), in which the Sixth Circuit held that a transaction involving solely an acquisition of property must be viewed as a whole "and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority." *Id.* at 591.

With the *Ashland* precedent in mind, the Tax Court in 1950 was faced with a situation where a fire had destroyed a milling company's assets. With the fire insurance proceeds, the company acquired 100% of the stock of another milling company. The subsidiary company was then liquidated, and the parent received the assets. The tax court held that when viewed as a single transaction, it amounted to a purchase of assets, and the taxpayer would receive a cost basis rather than a carryover. *Kimbell-Diamond,* 14 T.C. at 80. The *Kimbell-Diamond* doctrine gave both the

taxpayer and the IRS a judicial exception to the statutory carryover basis rule and became an often used procedure in cases under the 1939 code. *See The South Bay Corporation v. C.I.R.*, 345 F.2d 698, 703 (2d Cir. 1965); *United States v. M.O.J. Corporation*, 274 F.2d 713, 717 (5th Cir. 1960); *United States v. Mattison*, 273 F.2d 13, 17 (9th Cir. 1959); *Georgia Properties Co. V. Henslee*, 138 F.Supp. 587, 590 (M.D.Tenn.1955).

In 1954, Congress added § 334(b)(2) to incorporate "rules effectuating principles derived from Kimbell-Diamond Milling Company. . . ." S.Rep.No.1622, 83d Cong., 2d Sess. (1954), *reprinted in* [1954] U.S.Code Cong. & Admin.News, pp. 4621, 4894. The legislative history, unfortunately, is not totally clear on whether § 334(b)(2) was enacted to supplant the *Kimbell-Diamond* doctrine or merely to borrow from it. Throughout the committee proceedings, the only mention of this is that § 334(b)(2) "effectuates" the principles of *Kimbell-Diamond*. *See* S.Rep.No.1622, 83d Cong., 2d Sess. (1954), *reprinted in* [1954] U.S.Code Cong. & Admin.News, pp. 4621, 4679, 4894; H.R. Rep.No.1337, 83d Cong., 2d Sess. (1954), *reprinted in* [1954] U.S.Code Cong. & Admin.News, pp. 4017, 4063, 4247.

The IRS has opposed the application of the *Kimbell-Diamond* doctrine to situations arising under the 1954 code.[10] In light of this conflict and unclear legislative history, the courts had grappled for almost two decades with the continuing vitality of the *Kimbell-Diamond* rule

10. The IRS manual lists the use of the *Kimbell-Diamond* doctrine as a "prime issue," one that it will litigate and will not usually concede or compromise. *See* [1980] 3 Stand.Fed.Tax.Rep. (CCH) ¶ 2434; 2 J. Rabkin & M. Johnson, Federal Income, Gift and Estate Taxation § 23.11(4) [hereinafter Rabkin & Johnson]. *But see American Potash & Chemical Corporation v. United States*, 402 F.2d 1000, 1001 n. 1, 185 Ct.Cl. 161 (1968) (IRS no longer argued that the *Kimbell-Diamond* approach is not viable but rather that it was inapplicable to the facts of the case); Rev.Rul. 74-35, 1974-1 C.B. 85 (In language implicitly recognizing the doctrine, IRS refers to Rev.Rul. 67-274, 1967-2 C.B. 141, which represented "an application of the *Kimbell-Diamond* principle.").

under the 1954 code. Without making an affirmative decision, the Fifth Circuit seemed to imply that the doctrine was still viable under the 1954 code in *Griswold v. C.I.R.*, 400 F.2d 427, 431 (5th Cir. 1968). As late as 1973, the tax court had not decided whether the doctrine could still be used in post-1954 situations. *See Yoc Heating Corporation v. C.I.R.*, 61 T.C. 168, 176 (1973); *Kass v. C.I.R.*, 60 T.C. 218, 223 n. 9 (1973).

In 1968, however, the Court of Claims affirmatively held that Congress did not intend to eliminate the *Kimbell-Diamond* by enacting § 334(b)(2). *American Potash & Chemical Corporation v. United States,* 399 F.2d 194, 207, 185 Ct.Cl. 161 (1968). The Court of Claims held that the rationale for the rule was based upon the notion that substance should prevail over form. *Id.* The Court of Claims concluded that Congress meant to inject a degree of certainty into the area of tax law by offering an objective route for obtaining a cost basis without the need for showing intent to acquire assets. *Id.* at 207-08. The Court of Claims found it anomalous that § 334(b)(2) applies only to corporate taxpayers, allowing individual taxpayers to avail themselves of the doctrine. *Id.* at 208. The Court of Claims also discerned no specific direction by Congress that the doctrine was defunct and, thus, refused to abolish it. *Id.* at 209. *See also Rose Hills Memorial Park Association v. United States,* 463 F.2d 425, 433, 199 Ct.Cl. 6 (1972), *cert. denied,* 414 U.S. 822, 94 S.Ct. 122, 38 L.Ed.2d 55 (1973) (affirming the viability of the *Kimbell-Diamond* doctrine.)

Shortly thereafter, a number of circuits refused to follow the holding in *American Potash.* In *Supreme Investment Corporation v. United States,* 468 F.2d 370, 377 (5th Cir. 1972), this court held that § 334(b)(2) is a codification of principles derived from the *Kimbell-Diamond* doctrine. This court also held that in enacting § 334(b)(2), Congress made a major change by substituting a series of objective tests in place of the taxpayers subjective intent to obtain corporate assets. *Id. Supreme Investment*

did not abolish the doctrine, however. Additionally, the facts in that case are distinguishable from the present case, since in *Supreme Investment,* the taxpayer had met all the requirements of § 334(b)(2).

The Ninth Circuit has been faced with the *Kimbell-Diamond* doctrine twice in *Pacific Transport Co. v. C.I.R.,* 483 F.2d 209 (9th Cir. 1973), *cert. denied,* 415 U.S. 948, 94 S.Ct. 1469, 39 L.Ed.2d 563 (1974), and *Boise Cascade Corporation v. United States,* 288 F.Supp. 770 (D.Idaho 1968), *aff'd per curiam,* 429 F.2d 426 (9th Cir. 1970). In *Boise Cascade,* the Ninth Circuit summarily affirmed a district court case which held that § 334(b)(2) eliminated the subjective intent test of *Kimbell-Diamond.* In *Pacific Transport,* the Ninth Circuit held that the *Kimbell-Diamond* philosophy is no longer controlling. *Pacific Transport Co. v. C.I.R.* 483 F.2d at 213. Again, however, both cases involved transactions which specifically qualified under § 334(b)(2).

The Seventh Circuit has also dealt with the application of the *Kimbell-Diamond* doctrine in *Broadview Lumber Co., Inc. v. United States,* 561 F.2d 698 (7th Cir. 1977). The facts in that case clearly involved a § 334(b)(1) transaction in which the government sought to use the *Kimbell-Diamond* doctrine to force the taxpayer to receive a cost basis. The Seventh Circuit held that the *Kimbell-Diamond* doctrine is inapplicable "in cases falling within the ambit of § 334(b)(2)," *id.* at 712 and n. 30, but it did not rule out the possibility that it might apply in situations where § 334(b)(2) is inapplicable. *Id.* at 712, 714.

In 1978, the Tax Court, deciding the point which it left unanswered in *Yoc Heating Corporation v. C.I.R.,* 61 T.C. 168 (1973), held that the only exception to § 334(b)(1) is found in § 334(b)(2), and, therefore, the *Kimbell-Diamond* doctrine has been abolished. *International State Bank v. C.I.R.,* 70 T.C. 173, 180-81 (1978).

There is no doubt that in situations where the objective requirements of § 334(b)(2) have been met, there is no

room for the *Kimbell-Diamond* doctrine. It is equally clear that § 334(b)(2)is a codification of the *Kimbell-Diamond* doctrine and was meant to allow a cost basis automatically without the need for proving the intent to acquire assets. *See Broadview Lumber Co.*, 561 F.2d at 711; *Supreme Investment*, 468 F.2d at 377; *Madison Square Garden Corporation v. C.I.R.*, 500 F.2d 611, 612 (2d Cir. 1974); 2 Rabkin & Johnson § 23.11(4). § 334(b)(2) is a mandatory and not an elective section. *See Broadview Lumber Co.*, 561 F.2d at 711, *Supreme Investment*, 468 F.2d at 377. If a corporate taxpayer complies with the procedures in § 334(b)(2) it must take a cost basis, even if it never had the initial intent to acquire the assets or receive a cost basis. *See Supreme Investment*, 468 F.2d at 377.

However, this court is not dealing with a situation where a corporation has fulfilled the statutory requirements of § 334(b)(2). Rather, we are asked to apply the *Kimbell-Diamond* doctrine in a factual situation in which § 334 (b)(2) has not been met. Outside of the Court of Claims and the Tax Court, the other courts which have dealt with the doctrine have never affirmatively held either way regarding the present factual scenario.[11]

The *Kimbell-Diamond* doctrine was a necessary outlet for the strict language of § 334's predecessor. Clearly, a purchase of stock and subsequent liquidation by the same corporation done wholly with the intent to acquire assets was no different than a direct purchase of assets, which resulted in a cost basis. *See Georgia-Pacific Corporation v. United States*, 264 F.2d 161, 163 (5th Cir. 1959).

11. Bittker & Eustice suggest that the *Kimbell-Diamond* doctrine may still possess vitality in cases where the statutory requirements of § 334(b)(2) are not satisfied. Bittker & Eustice ¶ 11.44, at 11-48. *See also Bonovitz, supra*, at 112-13, writing before the 5th, 7th and 9th Circuits had rendered their decisions, in which he states that although a situation identical to the present one might not qualify under § 334(b)(2), the courts are reluctant to take a formalistic approach and will probably apply the doctrine. Since that publication, the courts have shown a reluctance to so apply the doctrine, and the Tax Court has clearly held against it.

Congress, however, recognized the need to codify such a practice and did so in 1954. § 113(a)(15) of the old code, which mandated the receipt of a carryover basis by a corporation upon the complete liquidation of another, became § 334(b)(1). Congress retained the carryover basis in such transactions "except as provided in paragraph (2) . . ." 26 U.S.C. § 334(b)(1). By 1954, Congress was well aware of the *Kimbell-Diamond* doctrine and its objective intent requirement, yet it provided for only that one exception to the carryover basis rule, found in § 334(b)(2). Congress included no provision allowing a subjective intent test to be used when § 334(b)(2) was not satisfied. Although the legislative history is opaque at best, it does demonstrate that Congress was inserting the principles of the *Kimbell-Diamond* doctrine in the statute.

By a plain reading of § 334(b)(1), however, it is apparent that Congress meant to codify the *Kimbell-Diamond* rule completely in § 334(b)(2). No other exception was enacted or acknowledged by Congress. The majority opinion of the Tax Court in *International State Bank,* thus, seems to be the correct interpretation of § 334.[12] Whenever property is received by a corporation in a distribution in complete liquidation of another corporation pursuant to § 332, the receiving corporation must take a carryover basis, unless and only unless the transaction qualifies for a cost basis under § 334(b)(2).

The Court of Claims, in its defense of the doctrine, questions the logic of § 334(b)(2)'s applicability to corporations and not individual taxpayers. *American Potash,* 399 F.2d at 208. Although it may seem anomalous, that does not give this court the right to twist the meaning of a statute which clearly requires satisfaction of certain prerequisites before a cost basis may be obtained. Congress

12. Judge Tannenwald, concurring in *International State Bank,* joined by two other judges, was reluctant to discard the doctrine. Judge Tannenwald advocated that in situations where § 334(b)(2) is not followed, the tax court "should not be prevented from utilizing the flexibility which the *Kimbell-Diamond* doctrine affords." *International State Bank,* 70 T.C. at 182 (Tannenwald, J., concurring).

either ignored or chose to exclude the individual taxpayers, but we may not assume from either alternative that this court thus has the right to equalize the situation. Congress has specifically provided for corporate taxpayers, and we are bound by that legislation.

This court is completely cognizant of the fundamental tax concept that substance should be exalted over form. *See C.I.R. v. Court Holding Co.*, 324 U.S. 331, 334, 65 S.Ct. 707, 89 L.Ed. 981 (1945); *United States v. Kennedy Construction Co. of NSB, Inc.*, 572 F.2d 492, 495 (5th Cir. 1978). The court is also aware that the *Kimbell-Diamond* rule was based upon the notion of substance over form. *Kimbell-Diamond,* 14 T.C. at 80. We cannot and do not refute this principle. In *Kimbell-Diamond,* it was a necessary tool to correct an apparent oversight by Congress. An appellate court, however, would be disserving itself and the taxpayers as well as committing legal dishonesty if, relying solely upon the notion that substance should prevail over form, it created additional exceptions to a statute which clearly corrected that prior oversight and provides for only one exception. The statute itself exalts form over substance. We may not act as a beneficent paternal rectifier of legislation which is not constitutionally deficient. In light of the provisions of § 334, there is simply no room to utilize the substance over form doctrine. *See Griswold v. C.I.R.*, 400 F.2d 427, 431 (5th Cir. 1968)(noting that the form of a transaction often controls the tax consequences).

Thus, we hold definitively and absolutely that the *Kimbell-Diamond* doctrine is extinct under the 1954 code regarding corporate taxpayers. The doctrine has been codified in § 334(b)(2), which is now the sole exception to the application of a carryover basis to corporations following the complete liquidation of another corporation. Although today's decision extinguishing the *Kimbell-Diamond* cuts against the taxpayer herein, that does not intimate that the taxpayer will always meet with failure. Rather the mechanistic approach of § 334(b)(2) gives the

corporate taxpayer an assurance that it will receive a cost basis if it only fulfills the statutory requirements. In truth, the *Kimbell-Diamond* doctrine itself was a double edged sword which could be and often was used by the IRS to require a taxpayer to receive a basis which the latter did not seek. *See Broadview Lumber Company,* 561 F.2d at 711 n. 28; *United States v. Mattison,* 273 F.2d at 17 n. 4.

This is a case in which it is quite fitting to apply Justice Holmes' oft cited phrase that "hard cases make bad law." *Northern Securities Co. v. United States,* 193 U.S. 197, 400, 24 S.Ct. 436, 48 L.Ed. 679 (1904) (Holmes, J., dissenting). This case seems inequitable to the Appellant. Chrome Plate truly believed that its transaction would qualify under § 334 (b)(2).[13] The sellers of the Page stock did realize a gain, and CPI did acquire the stock by purchase. Likewise, PIOI met all the mechanical requirements of the liquidation. But the same corporation that made the purchase did not receive the property due to the prohibited § 351 transaction. Even so, it may appear inequitable to not retain the *Kimbell-Diamond* doctrine in such a case. But to do so would require a convoluted reading of § 334(b)(2), its purpose and its history. If we retained the *Kimbell-Diamond* doctrine in a hard case such as this one, we would undoubtedly be creating bad law. We refuse to do so.

We hold positively and conclusively that the *Kimbell-Diamond* doctrine is abolished in regard to corporate taxpayers, and the only opportunity to receive a cost basis in complete liquidation of a subsidiary is by fully complying with § 334(b)(2). In the present case, the Appellant will not be allowed a cost basis under § 334(b)(2) because of the inclusion of a § 351 transfer in the transaction. The Appellant is therefore required to take a carryover basis under § 334(b)(1).

AFFIRMED.

13. Although the Appellant was clearly aware of § 334(b)(2), it cannot be faulted for its actions. When the transaction was planned and consummated, the only case law available was that of *American Potash.* Both the Appellant's accountant and attorney relied upon that case and truly believed that a cost basis would be applicable pursuant to the *Kimbell-Diamond* doctrine.

APPENDIX B

CHROME PLATE, INC.
v.
DISTRICT DIRECTOR OF INTERNAL REVENUE

No. SA-75-68-BK

United States District Court
Western District of Texas
San Antonio Division
November 7, 1977

MEMORANDUM ORDER

SUTTLE, District Judge.

This case comes before the court on an appeal by the Defendant from a decision of the bankruptcy court. Jurisdiction is founded on § 23 of the Bankruptcy Act, 11 U.S.C. § 46.

There are three issues on appeal: the Defendant alleges that the bankruptcy court lacked subject-matter jurisdiction to entertain the Plaintiff's claim that it was owed a tax refund by the United States; the Defendant maintains that the bankruptcy court erred in allowing Plaintiff's subsidiary to take a stepped-up basis in assets received in the liquidation of six corporations, contending that § 334(b)(1) of the Internal Revenue Code, 26 U.S.C. § 334(b)(1), applies to the transaction; and the Plaintiff now asserts that it is entitled to attorney's fees under The Civil Rights Attorney's Fees Awards Act of 1976, 42 U.S.C. § 1988. Since this is a Chapter XI rearrangement, the Plaintiff bankrupt has been allowed to function as a debtor in possession.

I

During the proceedings below, the bankruptcy judge upheld the Plaintiff's claim that it was entitled to an income tax refund of $135,557.18 from the United States. The gist of the claim was that an account receivable

became worthless during 1973, thus giving rise to a bad business debt.[1] The law is settled that an income tax refund based on payments made prior to the filing of a bankruptcy petition constitutes "property" to which title vests in the trustee under § 70(a)(5) of the Bankruptcy Act, 11 U.S.C. § 110(a)(5). *Kokoszka v. Belford,* 417 U.S. 642, 94 S.Ct. 2431, 41 L.Ed.2d 374 (1974). The Government contends, however, that the Plaintiff pursued its refund claim in the wrong forum: that to the extent the Plaintiff was seeking affirmative relief the bankruptcy court was without subject-matter jurisdiction to entertain the complaint. This court finds that the Government is correct.

A.

It is beyond dispute that, as a sovereign, the United States cannot be sued without its consent. *Affiliated Ute Citizens of Utah v. United States,* 406 U.S. 128, 141-42, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1972); *United States v. Sherwood,* 312 U.S. 584, 586, 61 S.Ct. 767, 85 L.Ed. 1058 (1941). By virtue of the Tucker Act, the United States has waived sovereign immunity and consented to be sued for the recovery of any internal revenue tax alleged to have been erroneously or illegally assessed or collected, 28 U.S.C. § 1346(a)(1). This is, of course, the exact nature of the Plaintiff's claim. Original jurisdiction to hear claims arising under the Act, however, is clearly limited under § 1346(a) to the district courts concurrent with the Court of Claims. The issue in this case thus becomes virtually indistinguishable from that confronted by the Ninth Circuit in *Danning v. United States,* 259 F.2d 305 (9th Cir. 1958), *cert. denied,* 359 U.S. 911, 79 S.Ct. 587, 3 L.Ed.2d 574 (1959): whether a bankruptcy court has jurisdiction to hear a counterclaim for affirmative relief asserted by the trustee against the United States that arises out of the same transaction as the claim filed by the Government in the bankruptcy proceedings. The *Danning* court found that the bankruptcy court lacked jurisdiction, holding that, absent a specific statutory waiver, "an affirmative judgment

1. The Plaintiff originally filed its claim for a refund with the Internal Revenue Service on June 7, 1976.

against the United States cannot be entered on a counterclaim without specific statutory authorization for affirmative relief against the government on the counterclaim as such." 259 F.2d at 309-310.

The United States has specifically consented to waive sovereign immunity with regard to the type of claim involved here: a suit for the refund of "erroneously" collected taxes. However, Congress has also specifically authorized that such suits may only be brought in a district court or the Court of Claims. This rigid requirement is not waived simply because the United States asserts a claim for taxes in a bankruptcy proceeding and the trustee wishes to raise a counterclaim and resolve both matters at once. The court is not unmindful of the purposes behind the Bankruptcy Act, especially the need and desirability for swift and complete adjudication of all of a bankrupt's debts and claims in a single proceeding. Nevertheless, if there is a clash between the purposes of the Bankruptcy Act and the principle of sovereign immunity, it is the Bankruptcy Act that must yield. As Professor Wright has written:

> Moreover, if Congress in fact has consented to a particular kind of suit, it may define the conditions under which it is willing to be sued and the general rule long has been that the government's consent is to be strictly interpreted. Thus, for example, an action may be brought only in the court designated . . . 14 Wright, Miller & Cooper, *Federal Practice and Procedure:* Jurisdiction § 3654, pp. 160-161 [footnotes omitted].

The Supreme Court reaffirmed this principle only last term in *United States v. Testan,* 424 U.S. 392, 399, 96 S.Ct. 948, 47 L.Ed.2d 114 (1976). *See* also *Safeway Portland E.F.C.U. v. Federal Dep. Ins. Corp.,* 506 F.2d 1213, 1216 (9th Cir. 1974). Thus, the court finds that the strict limitations of 28 U.S.C. § 1346(a)(1) preclude the bankruptcy judge from exercising subject-matter jurisdiction over the Plaintiff's claim.

B.

In order to avoid potential problems in future litigation, the court believes it necessary to correct a fundamental error in the bankruptcy judge's findings. The judge held that even a strict construction of § 1346(a)(1) would not present a bar to that court's reaching a determination of the Plaintiff's claim. He based his conclusion upon the definition given "courts of bankruptcy" by § 1(10) of the Bankruptcy Act, 11 U.S.C. § 1(10):

> [they] shall include the United States district courts and the district courts of the Territories and possessions to which this Act is or may hereafter be applicable.

From this definition, the bankruptcy judge apparently deduced that Congress intended for bankruptcy courts to function as district courts. This assessment is the exact converse of the situation. District courts have traditionally been empowered to sit as courts of bankruptcy. When they do so, their jurisdiction and powers are *limited* to those conferred upon them by the Bankruptcy Act. *First State Bank, etc. v, Sand Springs State Bank,* 528 F.2d 350, 353 (10th Cir. 1976). Bankruptcy courts also sit as courts of bankruptcy. That is all they do. They are not district courts, nor can they function as such. Their powers and jurisdiction are also derived solely from the scope of the Act, *Katchen v. Landy,* 382 U.S. 323, 327, 86 S.Ct. 467, 15 L.Ed.2d 391 (1966); *In re Harwald Company,* 497 F.2d 443 (7th Cir. 1974); their jurisdictional bounds cannot exceed it.

II

The second question before the court concerns the proper basis to be applied to assets that the Plaintiff received in the liquidation of six subsidiary corporations. The rules for determining such bases are found in I.R.C. § 334(b); subsection (1) provides the general rule, which requires a carryover basis, while subsection (2) provides a limited exception to that rule that allows a corporation to take a stepped-up or cost basis. The Government contends that

the transaction by which the Plaintiff acquired its subsidiaries was a transfer within the purview of I.R.C. § 351; that a transfer of this nature closes the door to a § 334(b)(2) exception thereby bringing the subsequent liquidation within the ambit of § 334(b)(1); and that, as a result, the Plaintiff's basis in the assets should equal that of the subsidiary corporations. The Plaintiff maintains that in passing § 334 Congress did not intend to preempt the doctrine of *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T.C. 74 (1950), *aff'd per curiam,* 187 F.2d 718 (5th Cir. 1951), *cert. denied,* 342 U.S. 827, 72 S.Ct. 50, 96 L.Ed. 626 (1951), which holds that, for purposes of determining tax liability, the substance of a transaction should be examined rather than the form: the ultimate purpose is the controlling factor rather than the various steps undertaken to achieve it. Applying that doctrine to its own transaction, the Plaintiff contends that, since its aim was to acquire the assets, the basis of those assets should be stepped-up to equal the Plaintiff's cost in acquiring them. The bankruptcy judge agreed with the Plaintiff and denied the Government's claim for $52,967.34 in income taxes. This court believes that the bankruptcy judge was in error and therefore reverses his decision.

The facts giving rise to the Government's claim are not in issue; they revolve around a series of corporate transactions by which the Plaintiff acquired six aircraft businesses owned by Clarence Page. On December 28, 1972, Page transferred all his stock in six corporations to Chrome Plate Industries, Inc. (CPII), a newly formed corporation (December 15, 1972) of which all the outstanding stock was owned by the Plaintiff.[2] Mr. Page received $850,000 in cash and notes for his stock. CPII then transferred its newly acquired Page stock to Page Industries of Oklahoma, Inc. (PIOI), in exchange for 849,000 shares of

2. Mr. Page had a partner, Mr. O.J. Butts, who owned 20 percent of the stock in one of the companies. Mr. Butts also transferred his stock to CPII as part of the deal; therefore, for convenience sake, this order shall refer to the businesses as the Page corporations.

PIOI common stock. PIOI was itself a newly formed corporation (December 12, 1972) and was a wholly owned subsidiary corporation of the Plaintiff. The day after these transactions commenced, December 29, 1972, the Page corporations were liquidated and PIOI succeeded to their assets. PIOI then stepped up the basis of those assets from their original cost to Page to their cost to PIOI, $849,000. It is this step-up that is in issue.

A.

The court must begin its inquiry with an analysis of the applicable sections of the Internal Revenue Code. The general rule for determining the basis of property received by a corporation from the liquidation of a subsidiary is found in § 334(b)(1):

> If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332(b)), then, except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the transferor . . .[3]

Section 334(b)(2) permits a distributee to use its own cost as the basis for the assets if the distribution itself meets certain prerequisites. At issue here is the requirement detailed in § 334(b)(2)(B) that:

> stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote . . . was acquired by the distributee by purchase (as defined in paragraph (3)) . . .

Paragraph (3), § 334(b)(3)(B), specifically excludes from the definition of "purchase" stock that is acquired in an exchange to which § 351 applies. The Government contends that PIOI acquired the Page corporation stock by virtue of a § 351 exchange with CPII, which, therefore, renders § 334(b)(2) inapplicable to the transaction.

3. There is no dispute that the liquidation involved here was "within the meaning of section 332(b)."

Section 351 governs transfers to a corporation controlled by the transferor. The general rule found in subsection (a) is:

> No gain or loss shall be recognized if property is transferred to a corporation . . . by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

Control, as defined by § 368(c), "means the ownership of stock possessing at least 80 percent of the total number of shares of all other classes of stock of the corporation." It is uncontroverted that CPII was in control of PIOI within the meaning of § 368(c) immediately after the exchange.

Retracing its steps through this thoroughly tangled web of statutory intrigue, the court believes that the issue—as far as concerns the application of the Internal Revenue Code to the transactions in question—is this: if the transfer of Page stock from CPII to PIOI was a transfer within the meaning of § 351, then when PIOI subsequently liquidated the Page stock it was precluded from adopting a § 334(b)(2) cost basis for assets it received; it was required, instead, to carryover the original Page basis for those assets under the terms of the general rule announced in § 334(b)(1). Thus, the court again turns its attention to the requirements of § 351.

"Persons" as it appears in § 351 has been defined to include, among others, individuals, trusts, and corporations. Treas. Reg. 1.351-1(a)(1). Thus CPII fits the definition of a transferor ("one or more persons") under § 351. There remains, however, the question whether the Page company stock transferred to PIOI comes within the definition of "property" for purposes of a § 351 exchange. Although there is no single case that expressly rules on this point, there has been a recent revenue ruling holding that the sole transferred property in a § 351 exchange may be the stock of another corporation. *RevRul 74-502,* 1974-2 CB, p. 117. Further, courts that have

examined the scope of § 351 "property" in other contexts are unanimous in holding that the term should be construed as broadly as possible. *See* e. g. *Hempt Bros., Inc. v. United States,* 490 F.2d 1172, 1175 (3rd Cir. 1974); *E. I. DuPont de Nemours and Co. v. United States,* 471 F.2d 1211, 1218-1219, 200 Ct.Cl. 391 (1973). Thus it seems clear to the court that, in terms of both the practical aspects of business life and the obvious intent of the statute, stock constitutes property within the meaning of § 351.

The court finds that the transfer of Page stock from CPII to PIOI was a § 351 exchange and, by the terms of § 334(b)(3)(B), does not fit the definition of a purchase necessary to permit PIOI to utilize the cost basis exemption provided by § 334(b)(2). When the corporate transactions are examined solely in accordance with the specific provisions of the Code, it is clear that PIOI was required to use the carryover basis for the assets mandated by § 334(b)(1).

B.

The Plaintiff contends that, regardless of the specific language found in the Code, § 334(b)(2) was not intended to preempt the *Kimbell-Diamond* doctrine. The bankruptcy court upheld this contention and also agreed with the Plaintiff that in order to determine the proper basis for the assets the *Kimbell-Diamond* rule requires a court to look at the substance of transactions in question—the specific intent of the corporation—rather than at the form or procedure that the corporation undertook. Thus, the bankruptcy judge did not even attempt to first determine whether the Plaintiff was entitled to use § 334(b)(2) but, instead, simply ignored the Code and applied pre-1954 Internal Revenue Code case-law to the transaction and held for the Plaintiff. This court, having considered the legislative history of § 334 as well as the cases that have interpreted the validity of *Kimbell-Diamond* in light of that section's enactment, finds that both the purpose and the effect of that section was to codify and define the scope of the *Kimbell-Diamond* doctrine; therefore, the exception to

the carryover basis rule afforded by that doctrine remains available only to the extent that a given liquidation meets the requirements of §334(b)(2).

Three circuit courts of appeal and the Court of Claims have considered the impact § 334(b)(2) has had upon *Kimbell-Diamond*; only the Court of Claims has held that the doctrine remains intact. That court, in *American Potash & Chemical Corporation v. United States,* 399 F.2d 194, 185 Ct.Cl. 161 (1968), rejected the Government's argument that § 334(b)(2) was the exclusive exception to the carryover basis rule. The court stated that a review of the legislative history of the 1954 Code indicated that although § 334(b)(2) was intended to "establish a precise rule under which a taxpayer could proceed" assured that it could use a cost-basis for assets it received in a subsequent liquidation, the statute was not intended to preempt *Kimbell-Diamond*; the doctrine of that case remained available for corporations that wanted to utilize a cost basis but neglected to insure that the transfers in question met the standards outlined in the statute. The difficulty with this interpretation is that its effect is to render § 334(b)(2) purposeless. If, as the Court of Claims suggests, a corporation has the option of either following the blueprint provided by § 334(b)(2) and taking a cost-basis or else ignoring those requirements and asserting *Kimbell-Diamond* to obtain that same cost-basis—to which, having failed to comply with the Code, it would otherwise no longer be entitled—then § 334(b)(2) is not a law but simply a piece of advice that Congress has graciously made available for those corporations that wish to claim a cost-basis without having to subsequently demonstrate their subjective intent.

There is not much legislative history regarding the enactment of § 334; however, the little there is does provide some insight into the purpose Congress intended it to serve. Although the House Report merely notes that "the consequences prescribed under § 334 reach results which . . . [effectuate] the principles of *Kimbell-Diamond*",

H.R.Rep. No. 1337, 83rd Cong., 2d Sess., (1954), 3 U.S.Code Cong. & Admin. News (1954) pp. 4017, 4247, the Senate Report is far more explicit:

> Paragraph (2) of subsection (b) incorporates into your committee bill *rules effectuating principles derived from Kimbell-Diamond Milling Co., supra.* [emphasis added]

S.Rep. 1622, 83rd Cong., 2d Sess. (1954), 3 U.S.Code Cont. & Admin.News (1954) pp. 4621, 4894. The report goes on to trace the details of those Code Provisions that provide the substance of the "rules" designed to effectuate those principles: the result is that only those transactions meeting the requirements of § 334(b)(2) are entitled to *Kimbell-Diamond* treatment. The report reveals the clear intent of Congress to take the broad *Kimbell-Diamond* doctrine and mold it into a series of rules that provide a concise framework and procedure within which those principles would operate. *See* 3 U.S.Code Cong. & Admin.News (1954) at pp. 4894-4895. That this was the purpose behind § 334(b)(2)—to regulate the use of the cost-basis exception—has been the conclusion reached by every circuit court that has considered the issue.

The Ninth Circuit has flatly held that the *Kimbell-Diamond* philosophy "is no longer controlling" in situations involving liquidations to which § 334(b) applies. *Pacific Transport Company v. Commissioner,* 483 F.2d 209, 213 (9th Cir. 1973), *cert. denied*, 415 U.S. 948, 94 S.Ct. 1469, 39 L.Ed.2d 563 (1974). The *Pacific Transport* court, adopting the reasoning of an earlier district court opinion, stated that the purpose of § 334(b)(2) was to eliminate the subjective intent test and replace it with a clear, objective standard against which a transaction could be measured; the intent of the taxpayer at the time the stock was acquired was no longer material. 483 F.2d at 213-214 citing *Boise Cascade Corp. V. United States,* 288 F.Supp. 770 (D.Idaho 1968), *aff'd per curiam,* 429 F.2d 426 (9th Cir. 1970).

The Fifth Circuit, although not specifically called on to decide this issue, has also expressed its opinion on the question:

> Section 334(b)(2) is a codification of principles derived from the decision in *Kimbell-Diamond Milling Co.* . . . [I]n codifying the *Kimbell-Diamond* rule Congress made a major change: it substituted a series of objective tests in place of a determination of the taxpayer's subjective intent to obtain corporation assets.

Supreme Investment Corporation v. United States, 468 F.2d 370, 377 (5th Cir. 1972).

Finally, in what this court believes is the most cogent and detailed opinion concerning the application of § 334(b)(2) to date, the Seventh Circuit has joined with the Ninth and the Fifth in rejecting the construction given § 334(b)(2) by the Court of Claims. *Broadview Lumber Company v. United States,* 561 F.2d 698 (7th Cir. 1977). The *Broadview* court held that the interpretation given § 334(b)(2) by the court of Claims would render that section "superfluous." The court further noted that one of the primary purposes behind codification of the *Kimbell-Diamond* doctrine was to formulate guidelines that would obviate the need for litigation that is so often produced by a test that attempts to measure subjective intent and that, if codification is to achieve this goal, the statute must be mandatory and limited to its terms. The court then discussed the content of § 334(b)(2) and expressly held that, if the transaction in question cannot satisfy the definition of "purchase" outlined in § 334(b)(2), then the terms of § 334(b)(2) have not been met and "the basis of the assets obtained in liquidation is carried over instead of stepped-up." 561 F.2d 713.

This court holds that the *Kimbell-Diamond* doctrine has been supplanted by § 344(b)(2) and therefore applies only to those transactions that satisfy the requirements of that provision. Since the liquidation of the Page stock was not one that met those requirements, PIOI was not entitled to apply a stepped-up basis to the assets it received.

III

The Plaintiff seeks an award of attorney's fees pursuant to the Civil Rights Attorney's Fees Award Act of 1976, 42, U.S.C. § 1988. The relevant portion of the statute provides:

> . . . [I]n any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code . . . the court, in its discretion, may allow the prevailing party, other than the United States, a reasonable attorney's fee as part of the costs.

The Plaintiff has attempted to buttress its claim by charging that the Government has brought this appeal in bad faith solely for the purpose of "harassment." This court finds the Plaintiff's charges totally devoid of merit.

Under ordinary circumstances, the court would simply note that, since the Plaintiff is not the prevailing party in this appeal, it is not entitled to an award under the statute. This, unfortunately, is not the ordinary circumstance: the Plaintiff has made a serious allegation that lacks the slightest degree of support in either brief or in the record.[4] Although a showing of bad faith by the Government would aid the Plaintiff's cause, it can hardly be argued that the mere fact that an appeal has been filed—especially one that is permitted as a matter of right and is based on grounds that are certainly far from frivolous—constitutes, without more, even the slightest degree of bad faith, much less harrassment. While the court does not in any way wish to discourage a party from seeking all forms of relief to which it may be entitled, no court can permit a party to cavalierly sprinkle its requests with unfounded allegations

4. The Plaintiff seems to believe that the Government is in bad faith because the basis on which it rests its claim for income taxes is a ground that has consistently been denied by all courts having occasion to consider it. This indicates that the Plaintiff's attorney either has not read the cases cited in the Government's brief or else has not understood them. There is no assertion of bad faith by the Government in appealing the bankruptcy court's decision to grant the Plaintiff's counterclaim; presumably this is because the Plaintiff's attorney is aware that the only case that is on all fours with the issue supports the Government's position.

intended to seriously impugn the integrity of the opposing party. Charges of this nature will, in the future, either be supported by facts or else left unsaid. The Plaintiff's claim for an award of attorney's fees is denied.

The judgment of the bankruptcy court is reversed, and this case is remanded to that court with instructions to allow the Government's claim for income taxes and to dismiss the Plaintiff's counterclaim for lack of jurisdiction.

APPENDIX C

In the Matter of CHROME PLATE, INC., Debtor

CHROME PLATE, INC., Plaintiff

v.

DISTRICT DIRECTOR OF INTERNAL REVENUE
Defendant
in Bankruptcy

No. SA-75-68-BK

In the United States District Court
For the Western District of Texas
San Antonio Division

July 28, 1977

JUDGMENT GRANTING PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT DENYING DEFENDANT'S PROOF OF CLAIM IN THE AMOUNT OF $52,967.34 AND DENYING DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT CLAIMING THIS COURT LACKS SUBJECT MATTER JURISDICTION OVER PLAINTIFF PROSECUTING A CLAIM FOR REFUND OF INCOME TAXES

JUDGMENT

THOMPSON, Bankruptcy Judge

At San Antonio, Texas.

On the 13th day of June, 1977, came on to be heard the Plaintiff's Motion for Partial Summary Judgment Denying Defendant's Proof of Claim in the Amount of $52,967.34 as a recoupment of tentative overassessment of income tax and Defendant's Motion for Partial Summary Judgment Claiming This Court Lacks Subject Matter Jurisdiction to entertain Plaintiff's claim for refund of income tax as affirmative relief.

The parties appeared in person and by counsel. The Court has read the pleadings, heard the evidence and the argument of counsel.

The Court is of the opinion and it is ORDERED that the Objection of the Plaintiff to the Defendant's proof of claim in the amount of $52,967.34 is sustained, and the claim is denied.

The Court is of the opinion and it is ORDERED that the motion by Defendant that this Court lacks subject matter jurisdiction to entertain Plaintiff's claim for refund is denied, and this Court does have jurisdiction to hear this matter.

In the Matter of CHROME PLATE, INC., Debtor

CHROME PLATE, INC., Plaintiff

v.

DISTRICT DIRECTOR OF INTERNAL REVENUE SERVICE
Defendant
in Bankruptcy

No. SA-75-68-BK

United States District Court
Western District of Texas
San Antonio Division

July 28, 1977

MEMORANDUM OF DECISION RE PLAINTIFF'S MOTION FOR PARTIAL SUMMARY JUDGMENT DENYING DEFENDANT'S PROOF OF CLAIM AND DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT CLAIMING THIS COURT'S LACK OF SUBJECT MATTER JURISDICTION OVER CLAIM FOR REFUND OF INCOME TAX

MEMORANDUM OF DECISION

This matter is before the Court on the Motion for Partial Summary Judgment Denying the Defendant's Claim in the amount of $52,967.34 as a recoupment of tentative overassessment of income tax. In the Defendant's Brief, it raised a second issue requesting a Partial Summary Judgment claims that this Court lacks subject matter jurisdiciton to hear claims for refunds as affirmative relief.

The first issue, the facts of which are uncontroverted, involves the tax consequences arising out of a series of corporate transactions by which plaintiff, Chrome Plate, Inc., acquired the aircraft businesses owned or controlled by Clarence E. Page in December of 1972. At that time,

plaintiff was a corporation primarily engaged in the business of chrome plating aircraft cylinders. Mr. Page was engaged in the sale and repair of airplanes and airplane engines through six wholly owned and partly owned corporations and a sole proprietorship. Mr. Page owned all of the outstanding stock of Jacobs-Page Aircraft Engine Company, Aircraft Cylinders, Inc., United Aircraft Engine Salvage Corporation, Page Aircraft Sales, Inc., and Page Exports, Inc.; he owned 80 percent of the outstanding stock of a sixth corporation, Page Air Parts, Inc. Mr. O.J. Butts owned the remaining 20 percent of the stock in Page Air Parts, Inc. (For convenience, the six corporations named above will be referred to hereafter as the "six Page corporations.") Mr. Page also owned a sole proprietorship doing business under the name of Page Aircraft Industries.

On December 28, 1972, Mr. Page and Mr. Butts transferred all of their stock in the six Page corporations to Chrome Plate Industries, Inc. Chrome Plate Industries, Inc., was a newly formed corporation incorporated on December 15, 1972, all of the outstanding stock of which was owned by plaintiff, Chrome Plate, Inc. In return for their stock in the six Page corporations, Mr. Page and Mr. Butts received from Chrome Plate Industries, Inc., $39,000 in cash and $811,000 in four-percent notes.

Immediately following its acquisition of the stock of the six Page corporations, Chrome Plate Industries, Inc., transferred this stock to Page Industries of Oklahoma, Inc. (PIOI), in exchange for 849,000 shares of the common stock of PIOI. PIOI was also a newly formed corporation incorporated on December 12, 1972. Upon its incorporation, PIOI had issued 1,000 shares of its stock to Chrome Plate Industries, Inc.; thus, PIOI was a wholly owned subsidiary of Chrome Plate Industries, Inc., immediately prior to its receipt of the stock of the six Page corporations from Chrome Plate Industries, Inc. On December 29, 1972, the six Page corporations were liquidated, and PIOI succeeded to their assets.

Upon liquidating the six Page corporations, PIOI stepped up the basis of the assets of these corporations in its hands to $849,000 from their cost basis in the hands of the six corporations. The Internal Revenue Service denied this stepped-up basis in the assets received from the six Page corporations, and determined that the basis of these assets in the hands of PIOI was the same as their basis in the hands of the six Page corporations; that is, PIOI was required to carry over the basis of these assets from the six Page corporations. The Internal Revenue Service reached this conclusion because it determined that PIOI received the stock of the six Page corporations from Chrome Plate Industries, Inc., in a transaction to which Section 351 of the Internal Revenue Code of 1954 (26 U.S.C.) applied.

The plaintiff entered into the series of transactions described above for the specific purpose of acquiring the assets of the six Page corporations. After extensive negotiation and research, the transaction was carefully planned and executed in order to fulfill the business as well as the tax needs of the parties. The plaintiff was represented by a Certified Public Accountant and an Attorney at Law. The tax consequences were studied by the Certified Public Accountant and he determined that for tax purposes the substance of the transaction was an asset acquisition and the steps employed to achieve this result should not and does not change the nature of the transaction. The Certified Public Accountant relied on the step transaction doctrine enunciated in the *Kimbell-Diamond Milling Company v. Commissioner*, 14 T.C. 74 (1950), *aff'd per curiam*, 187 F.2d 78, which remains viable and was not preempted by the Internal Revenue Code Section 334(b)(2). The step transaction doctrine which was introduced and argued by the Internal Revenue Service is an attempt to analyze and look through the form of the transaction to the reality of the transaction. In the *Kimbell-Diamond* case, the Internal Revenue Service successfully argued that one must determine the substance of the transaction as opposed to the form and disregard the separate

steps taken to accomplish the primary objective and consider the transaction a single transaction. In the instant case, the Internal Revenue Service takes the position that the *Kimbell-Diamond* case was heard and decided prior to the enactment of the Internal Revenue Code of 1954 and now the step transaction doctrine should be disregarded in this particular instance. The Internal Revenue Service asks this Court to look to the form of the transaction over the substance of the transaction and apply the literal wording of the Internal Revenue Code, Section 334(b)(3). This issue has been raised and decided in two cases in two different courts subsequent to the passage of the Internal Revenue Code of 1954. In 1968, in *American Potash and Chemical Corporation v. U.S.*, 399 F.2d 194 (Ct. Cl. 1968), the Court specifically addressed this question. The Court held that the *Kimbell-Diamond* doctrine had not been preempted by the Internal Revenue Code of 1954 and the doctrine was still viable, and one must still look to the substance of the transaction as opposed to the form. In a later case, *Broadview Lumber Company, Inc. v. U.S.*, 36 AFTR 2d 75-6367, the Court held that "the Court rejects the defendant's position that Congress in enacting 334(b)(2) preempted the *Kimbell-Diamond* doctrine. Rather, the Court chooses to follow the position of the Court of Claims in *American Potash and Chemical Corporation v. U.S., supra,* that *Kimbell-Diamond* is still viable despite the enactment of 334(b)(2)."

In the instant case, the purported "steps" of the transaction were almost simultaneous. Had the order of the steps been changed, there was no question that the corporation would be entitled to a stepped-up basis pursuant to Section 334(b)(2). Regardless of the order of the "steps" the end result of the transaction is exactly the same. Clearly, the substance of the transaction was an asset acquisition and the plaintiff is entitled to a basis in the assets equal to what they paid for them.

In its arguments before this Court, the Internal Revenue Service recognized the *Kimbell-Diamond* doctrine, and the

Court's upholding that doctrine in *American Potash and Chemical Corporation* and *Broadview Lumber Company, Inc.* The argument presented by the Internal Revenue Service is that those courts were wrong in their interpretation of the law and that this Court should follow the specific language of the Internal Revenue Code and disregard the judicial determinations of the previous cases. This Court elects to follow the judicial precedent set by numerous courts during the past seventeen years and holds that the step transaction doctrine as enunciated in *Kimbell-Diamond* is still viable. Accordingly it is the opinion of this Court that the taxpayer is justly entitled to a step up in basis of the assets and denies the claim by the Internal Revenue Service in the amount of $52,967.34.

The second issue before this Court is whether or not this Court has summary jurisdiction to entertain plaintiff's claim for refund to the extent that it seeks affirmative relief. In taking its position, the Internal Revenue Service claims that this Court lacks summary jurisdiction relying on *Danning v. United States*, 259 F.2d 305 (C.A. 9, 1958), cert. denied 359 U.S. 911 (1959), because the plaintiff seeks affirmative relief. The Internal Revenue Service claims its result is obtained because of the doctrine of sovereign immunity which requires that the sovereign specifically consents to be sued, citing *United States v. Shaw,* 309 U.S. 495 (1940). The court held in *Danning, supra,* P. 309:

> "failing to find a specific statutory waiver, and having no power to find one by implication or interpretation, we are bound by the long line of cases to hold that an affirmative judgment against the United States cannot be entered on a counterclaim without specific statutory authorization for affirmative relief against the government on the counterclaim as such."

The above cited cases do not apply in the instant case because there is specific statutory language granting jursidiction to the District Courts concurrent with the Court of Claims granting original jursdiction in any civil action

against the United States for the recovery of any Internal Revenue tax alleged to have been erroneously or illegally assessed and collected 28 U.S.C.A. §1346(a)(1). The Bankruptcy Act, Chapter I, §1(10) defines Bankruptcy Courts as follows:

> Courts in bankruptcy "shall include the United States district courts and the district courts of the Territories and possessions to which this Act is or may hereafter be applicable."

Therefore, this court falls within 28 U.S.C.A. §1346(a)(1).

The cases cited by the Internal Revenue Service were decided prior to the adoption of the Bankruptcy rules which include Part VII, Adversary Proceedings. Under the Rules of Bankruptcy Procedure, Part VII, Adversary Proceedings, Rule 701 provides that "the rules of this Part VII govern any proceeding instituted by a party before the bankruptcy judge to recover money or property." A claim for refund of previously paid income taxes is merely a claim to recover money for the Internal Revenue Service. Therefore, in accordance with Part VII, this Court has jurisdiction.

The right for the claim for refund was created on December 31, 1973, and continues through today. Thus, the plaintiff owned and constructively possessed the asset the date of filing of the petition in bankruptcy, which was February 10, 1975. Upon the filing of a petition in bankruptcy, all property in bankrupt's actual or constructive possession passes at once into custody of the Bankruptcy Court. It is settled that the Bankruptcy Courts have summary jurisdiction to adjudicate controversies relating to property over which they have actual or constructive possession. In Re *American Southern Publishing Company,* 426 F.2d 160 (1970); In Re *Naviera Azta, S.A.,* 500 F.2d 390 (1974). Since this Court has constructive possession of plaintiff's right of claim for refund, it follows that this Court has jurisdiction to adjudicate the questions relating to it.

In addition to the above, Rule 915(a), Waiver of Objection to Jurisdiction, states that a party waives objection to jurisdiction in any adversary proceeding for a contested matter and thereby consents to such jurisdiction if he does not make objection in a timely motion or answer, whichever occurs first. The Advisory Committee notes to Rule 915 states that the premise of Subsection (a) is that a party to a controversy being litigated in the Bankruptcy Court must object to the Court's jurisdiction at the first opportunity in order to avoid being deemed to have consented thereto. In defendant's answer, it did not object to the jurisdiction of this Court, it merely questioned whether it had summary jurisdiction. The Internal Revenue Service did not object to the Referee to act as Judge, nor whether the Court had jurisdiction. This Court finds that the Internal Revenue Service did not properly object to the jurisdiction question.

Accordingly, it is the opinion of this Court that it does have summary jurisdiction to entertain plaintiff's claim for refund and denies defendant's motion for partial summary judgment questioning such jurisdiction.

APPENDIX D

Internal Revenue Code of 1954 (26 U.S.C.):

Sec. 332. Complete liquidations of subsidiaries.

(a) General Rule

No gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation.

(b) Liquidations to Which Section Applies.

For purposes of subsection (a), a distribution shall be considered to be in complete liquidation only if—

(1) the corporation receiving such property was, on the date of the adoption of the plan of liquidation, and has continued to be at all times until the receipt of the property, the owner of stock (in such other corporation) possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and the owner of at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends); and either

(2) the distribution is by such other corporation in complete cancellation or redemption of all its stock, and the transfer of all the property occurs within the taxable year; in such case the adoption by the shareholders of the resolution under which is authorized the distribution of all the assets of such corporation in complete cancellation or redemption of all its stock shall be considered an adoption of a plan of liquidation, even though no time for the completion of the transfer of the property is specified in such resolution; or

(3) such distribution is one of a series of distributions by such other corporation in complete cancellation or redemption of all its stock in accordance with a plan of liquidation under which the transfer of all the property under the liquidation is to be completed within 3 years from the close of the taxable year during

which is made the first of the series of distributions under the plan, except that if such transfer is not completed within such period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, no distribution under the plan shall be considered a distribution in complete liquidation.

If such transfer of all the property does not occur within the taxable year, the Secretary or his delegate may require of the taxpayer such bond, or waiver of the statute of limitations on assessment and collection, or both, as he may deem necessary to insure, if the transfer of the property is not completed within such 3-year period, or if the taxpayer does not continue qualified under paragraph (1) until the completion of such transfer, the assessment and collection of all income taxes then imposed by law for such taxable year or subsequent taxable years, to the extent attributable to property so received. A distribution otherwise constituting a distribution in complete liquidation within the meaning of this subsection shall not be considered as not constituting such a distribution merely because it does not constitute a distribution or liquidation within the meaning of the corporate law under which the distribution is made; and for purposes of this subsection a transfer of property of such other corporation to the taxpayer shall not be considered as not constituting a distribution (or one of a series of distributions) in complete cancellation or redemption of all the stock of such other corporation, merely because the carrying out of the plan involves (A) the transfer under the plan to the taxpayer by such other corporation of property, not attributable to shares owned by the taxpayer, on an exchange described in section 361, and (B) the complete cancellation or redemption under the plan, as a result of exchanges described in section 354, of the shares not owned by the taxpayer.

* * *

Sec. 334. Basis of property received in liquidations.

* * *

(b) Liquidation of Subsidiary.

(1) In general. If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332 (b)), then, except as provided in paragraph (2), the basis of the property in the hands of the distributee shall be the same as it would be in the hands of the tranferor. If property is received by a corporation in a transfer to which section 332 (c) applies, and if paragraph (2) of this subsection does not apply, then the basis of the property in the hands of the transferee shall be the same as it would be in the hands of the transferor.

(2) Exception. If property is received by a corporation in a distribution in complete liquidation of another corporation (within the meaning of section 332 (b)), and if—

(A) the distribution is pursuant to a plan of liquidation adopted not more than 2 years after the date of the transaction described in subparagraph (B) (or, in the case of a series of transactions, the date of the last such transaction); and

(B) stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), was acquired by the distributee by purchase (as defined in paragraph (3)) during a 12-month period beginning with the earlier of—

(i) the date of the first acquisition by purchase of such stock, or

(ii) if any of such stock was acquired in an acquisition which is a purchase within the meaning of the second sentence of paragraph (3), the date

on which the distributee is first considered under section 318 (a) as owning stock owned by the corporation from which such acquisition was made,

then the basis of the property in the hands of the distributee shall be the adjusted basis of the stock with respect to which the distribution was made. For purposes of the preceding sentence, under regulations prescribed by the Secretary or his delegate, proper adjustment in the adjusted basis of any stock shall be made for any distribution made to the distributee with respect to such stock before the adoption of the plan of liquidation, for any money received, for any liabilities assumed or subject to which the property was received, and for other items.

(3) Purchase defined.—For purposes of paragraph (2)(B), the term, "purchase" means any acquisition of stock, but only if—

(A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (ii) under section 1014 (a) relating to property acquired from a decedent,

(B) the stock is not acquired in an exchange to which section 351 applies; and

(C) the stock is not acquired from a person the ownership of whose stock would, under section 318 (a), be attributed to the person acquiring such stock.

Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2) (B), the term "purchase" also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318 (a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence).

(4) Distributee defined.—For purposes of this subsection, the term "distributee" means only the corporation which meets the 80 percent stock ownership requirements specified in section 332(b).

(c) Property Received in Liquidation Under Section 333.—If—

(1) property was acquired by a shareholder in the liquidation of a corporation in cancellation or redemption of stock, and

(2) with respect to such acquisition—

(A) gain was realized, but

(B) as a result of an election made by the shareholder under section 333, the extent to which gain was recognized was determined under section 333,

then the basis shall be the same as the basis of such stock cancelled or redeemed in the liquidation, decreased in the amount of any money received by the shareholder, and increased in the amount of gain recognized to him.

Sec. 351. Transfer to corporation controlled by transferor.

(a) General Rule.—No gain or loss shall be recognized if property is tranferred to a corporation (including, in the case of transfers made on or before June 30, 1967, an investment company) by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation. For purposes of this section, stock or securities issued for services shall not be considered as issued in return for property.

* * *

Sec. 368. Definitions relating to corporate reorganizations.

* * *

(c) Control.—For purposes of part I (other than section 304), part II, and this part, the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Step transaction doctrine, promulgated in *C.I.R. v. Ashland Oil & Refinery Co.*, 99 F.2d 588 (6th Cir. 1938), *cert. denied,* 306 U.S. 661, 59 S.Ct. 786, 83 L.Ed. 1057 (1939). A transaction involving solely an acquisition of property must be viewed as a whole "and closely related steps will not be separated either at the instance of the taxpayer or the taxing authority." *Id.* at 591.

Substance Over Form Doctrine, also known as the *Kimbell-Diamond Doctrine*, promulgated in *Kimbell-Diamond Milling Co. v. Commissioner,* 14 T.C. 74 (1950). *Aff'd per curiam*, 187 F.2d 718 (5th Cir. 1951), *cert. denied,* 342 U.S. 827, 72 S.Ct. 50, 96 L.Ed. 626 (1951). When a taxpayer, solely interested in acquiring a corporation's assets, purchased stock and then liquidated the acquired corporation, the transaction would be viewed as a purchase of assets and the various steps would be considered a single transaction.